Mergers & Acquisitions in India

With specific reference to Competition Law

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Nishith Desai Associates

www.nishithdesai.com

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I. Introduction

The financial year 2010-11 witnessed a slew of acquisitions across diverse sectors of the economy in India. Though the market dipped slightly in the second and third quarters of 2011, the number and value of M&A deals remained comparable to the corresponding periods in 2010.

While blatant display of global ambitions by Indian companies through outbound deals worth USD 27.25 billion was the key M&A trend in 2010, the shift from outbound deals to inbound deals has been the notable M&A trend in 2011.[1] During the first three quarters of 2011, the inbound deals totaled a transaction value of about USD 18.63 billion across 91 deals when only 63 inbound deals worth USD 6.60 billion were consummated during the same period in 2010.[2] Several inbound deals have been consummated recently at premium valuations highlighting that Indian businesses have become lucrative investment opportunities for global corporates.

On the other hand, outbound deals declined in the first three quarters of 2011 with 115 deals for a total value of about USD 9.58 billion as against 147 deals worth over USD 18.53 billion during the same period in 2010. Also, the Indian M&A market saw a steep fall in the number of domestic deals in 2011 with 260 deals worth USD 4.44 billion during the first three quarters in 2011, as against USD 17.28 billion deal value across 301 deals in 2010.[3]

The first half of 2011 saw 5 M&A deals valued at over a billion dollars each, with British Petroleum's USD 7.2 billion acquisition of the oil & gas assets of Reliance Petroleum and Vodafone Group's USD 5 billion worth acquisition of Vodafone Essar topping the charts. At the halfway mark for 2011, the oil & gas sector with M&A deals worth USD 9.07 billion dominated the Indian M&A arena with the telecom sector close on its heels.

In the sections that follow, we provide an overview of different laws to educate the reader of the broader areas of law which would be of significance for doing an M&A deal in India.

Mergers and acquisitions are methods by which distinct businesses may combine. Joint ventures are another way for two businesses to work together to achieve growth as partners in progress, though a joint venture is more of a contractual arrangement between two or more businesses.

A. Mergers And Amalgamations.

The term 'merger' is not defined under the Companies Act, 1956 (the "**Companies Act**"), the Income Tax Act, 1961 (the "**ITA**") or any other Indian law. Simply put, a merger is a combination of two or more distinct entities into one; the desired effect being not just the accumulation of assets and liabilities of the distinct entities, but to achieve several other benefits such as, economies of scale, acquisition of cutting edge technologies, obtaining access into sectors / markets with established players etc. Generally, in a merger, the merging entities would cease to be in existence and would merge into a single surviving entity.

Very often, the two expressions "merger" and "amalgamation" are used synonymously. But there is, in fact, a difference. Merger generally refers to a circumstance in which the assets and liabilities of a company (merging company) are vested in another company (the merged company). The merging entity loses its identity and its shareholders become shareholders of the merged company. On the other hand, an amalgamation is an arrangement, whereby the assets and liabilities of two or more companies (amalgamating companies) become vested in another company (the amalgamated company). The amalgamating companies all lose their identity and emerge as the amalgamated company; though in certain transaction structures the amalgamated company may or may not be one of the original companies. The shareholders of the amalgamating companies become shareholders of the amalgamated company.

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[1] http://www.thehindubusinessline.com/features/investment-world/article2308796.ece

[2] Dealtracker, Half yearly 2011, Grant Thornton

[3] *Ibid*

While the Companies Act does not define a merger or amalgamation, Sections 390 to 394 of the Companies Act deal with the analogous concept of schemes of arrangement or compromise between a company, it shareholders and/or its creditors. A merger of a company 'A' with another company 'B' would involve two schemes of arrangements, one between A and its shareholders and the other between B and its shareholders. Sections 390 to 394 are discussed in greater detail in **Part II** of this paper.

The ITA defines the analogous term 'amalgamation' as the merger of one or more companies with another company, or the merger of two or more companies to form one company. The ITA goes on to specify certain other conditions that must be satisfied for the merger to be an 'amalgamation' which conditions are discussed in **Part VI** of this paper.

Mergers may be of several types, depending on the requirements of the merging entities:

Horizontal Mergers**.** Also referred to as a 'horizontal integration', this kind of merger takes place between entities engaged in competing businesses which are at the same stage of the industrial process.[4] A horizontal merger takes a company a step closer towards monopoly by eliminating a competitor and establishing a stronger presence in the market. The other benefits of this form of merger are the advantages of economies of scale and economies of scope.

Vertical Mergers**.** Vertical mergers refer to the combination of two entities at different stages of the industrial or production process. For example, the merger of a company engaged in the construction business with a company engaged in production of brick or steel would lead to vertical integration. Companies stand to gain on account of lower transaction costs and synchronization of demand and supply. Moreover, vertical integration helps a company move towards greater independence and self-sufficiency. The downside of a vertical merger involves large investments in technology in order to compete effectively.

Congeneric Mergers**.** These are mergers between entities engaged in the same general industry and somewhat interrelated, but having no common customer-supplier relationship. A company uses this type of merger in order to use the resulting ability to use the same sales and distribution channels to reach the customers of both businesses.[5]

Conglomerate Mergers**.** A conglomerate merger is a merger between two entities in unrelated industries. The principal reason for a conglomerate merger is utilization of financial resources, enlargement of debt capacity, and increase in the value of outstanding shares by increased leverage and earnings per share, and by lowering the average cost of capital.[6] A merger with a diverse business also helps the company to foray into varied businesses without having to incur large start-up costs normally associated with a new business.

Cash Merger**.** In a typical merger, the merged entity combines the assets of the two companies and grants the shareholders of each original company shares in the new company based on the relative valuations of the two original companies. However, in the case of a 'cash merger', also known as a 'cash-out merger', the shareholders of one entity receive cash in place of shares in the merged entity. This is a common practice in cases where the shareholders of one of the merging entities do not want to be a part of the merged entity.

Triangular Merger**.** A triangular merger is often resorted to for regulatory and tax reasons. As the name suggests, it is a tripartite arrangement in which the target merges with a subsidiary of the acquirer. Based on which entity is the survivor after such merger, a triangular merger may be forward (when the target merges into the subsidiary and the subsidiary survives), or reverse (when the subsidiary merges into the target and the target survives).

[4] 'Corporate Mergers Amalgamations and Takeovers', J.C Verma, 4th edn., 2002, p.59

[5] 'Financial Management and Policy-Text and Cases', V.K Bhalla, 5th revised edn., p.1016

[6] *Ibid*, note 4, at p. 59

B. **<u>Acquisitions.</u>**

An acquisition or takeover is the purchase by one company of controlling interest in the share capital, or all or substantially all of the assets and/or liabilities, of another company. A takeover may be friendly or hostile, depending on the offeror company's approach, and may be effected through agreements between the offeror and the majority shareholders, purchase of shares from the open market, or by making an offer for acquisition of the offeree's shares to the entire body of shareholders.

<u>Friendly takeover</u>**.** Also commonly referred to as 'negotiated takeover', a friendly takeover involves an acquisition of the target company through negotiations between the existing promoters and prospective investors. This kind of takeover is resorted to further some common objectives of both the parties.

<u>Hostile Takeover</u>**.** A hostile takeover can happen by way of any of the following actions: if the board rejects the offer, but the bidder continues to pursue it or the bidder makes the offer without informing the board beforehand.

<u>Leveraged Buyouts</u>**.** These are a form of takeovers where the acquisition is funded by borrowed money. Often the assets of the target company are used as collateral for the loan. This is a common structure when acquirers wish to make large acquisitions without having to commit too much capital, and hope to make the acquired business service the debt so raised.

<u>Bailout Takeovers</u>**.** Another form of takeover is a 'bail out takeover' in which a profit making company acquires a sick company. This kind of takeover is usually pursuant to a scheme of reconstruction/rehabilitation with the approval of lender banks/financial institutions. One of the primary motives for a profit making company to acquire a sick/loss making company would be to set off of the losses of the sick company against the profits of the acquirer, thereby reducing the tax payable by the acquirer. This would be true in the case of a merger between such companies as well.

Acquisitions may be by way of acquisition of shares of the target, or acquisition of assets and liabilities of the target. In the latter case it is usual for the business of the target to be acquired by the acquirer on a going concern basis, i.e. without attributing specific values to each asset / liability, but by arriving at a valuation for the business as a whole (in the context of the ITA, such an acquisition is referred to as a 'slump sale' and discussed in greater detail in **Part VI** of this paper).

An acquirer may also acquire a target by other contractual means without the acquisition of shares, such as agreements providing the acquirer with voting rights or board rights. It is also possible for an acquirer to acquire a greater degree of control in the target than what would be associated with the acquirer's stake in the target, e.g., the acquirer may hold 26% of the shares of the target but may enjoy disproportionate voting rights, management rights or veto rights in the target.

C. **<u>Joint Ventures.</u>**

A joint venture is the coming together of two or more businesses for a specific purpose, which may or may not be for a limited duration. The purpose of the joint venture may be for the entry of the joint venture parties into a new business, or the entry into a new market, which requires the specific skills, expertise, or the investment of each of the joint venture parties. The execution of a joint venture agreement setting out the rights and obligations of each of the parties is usually a norm for most joint ventures. The joint venture parties may also incorporate a new company which will engage in the proposed business. In such a case, the byelaws of the joint venture company would incorporate the agreement between the joint venture parties.

D. **DEMERGERS.**

A demerger is the opposite of a merger, involving the splitting up of one entity into two or more entities. An entity which has more than one business, may decide to ‘hive off’ or ‘spin off’ one of its businesses into a new entity. The shareholders of the original entity would generally receive shares of the new entity.

If one of the businesses of a company is financially sick and the other business is financially sound, the sick business may be demerged from the company. This facilitates the restructuring or sale of the sick business, without affecting the assets of the healthy business. Conversely, a demerger may also be undertaken for situating a lucrative business in a separate entity. A demerger, may be completed through a court process under the Merger Provisions, but could also be structured in a manner to avoid attracting the Merger Provisions.

II. Mergers and Amalgamations: Key Corporate and Securities Laws Considerations.

A. **<u>Companies Act, 1956</u>**.

Sections 390 to 394 (the "**Merger Provisions**") of the Companies Act govern a merger of two or more companies (the provisions of Sections 390-394 are set out in **Annexure 1** for reference) under Indian law. The Merger Provisions are in fact worded so widely, that they would provide for and regulate all kinds of corporate restructuring that a company may possibly undertake; such as mergers, amalgamations, demergers, spin-off /hive off, and every other compromise, settlement, agreement or arrangement between a company and its members and/or its creditors.

<u>Procedure under the Merger Provisions</u>. Since a merger essentially involves an arrangement between the merging companies and their respective shareholders, each of the companies proposing to merge with the other(s) must make an application to the Company Court[7] (the "**Court**") having jurisdiction over such company for calling meetings of its respective shareholders and/or creditors. The Court may then order a meeting of the creditors/shareholders of the company. If the majority in number representing 3/4th in value of the creditors/shareholders present and voting at such meeting agrees to the merger, then the merger, if sanctioned by the Court, is binding on all creditors/shareholders of the company. The Court will not approve a merger or any other corporate restructuring, unless it is satisfied that all material facts have been disclosed by the company. The order of the Court approving a merger does not take effect until a certified copy of the same is filed by the company with the Registrar of Companies.

The Merger Provisions constitute a comprehensive code in themselves, and under these provisions Courts have full power to sanction any alterations in the corporate structure of a company that may be necessary to effect the corporate restructuring that is proposed. For example, in ordinary circumstances a company must seek the approval of the Court for effecting a reduction of its share capital. However, if a reduction of share capital forms part of the corporate restructuring proposed by the company under the Merger Provisions, then the Court has the power to approve and sanction such reduction in share capital and separate proceedings for reduction of share capital would not be necessary.

<u>Applicability of Merger Provisions to foreign companies</u>. Section 394 vests the Court with certain powers to facilitate the reconstruction or amalgamation of companies, i.e. in cases where an application is made for sanctioning an arrangement that is:

- for the reconstruction of any company or companies or the amalgamation of any two or more companies; and
- under the scheme the whole or part of the undertaking, property or liabilities of any company concerned in the scheme (referred to as the 'transferor company') is to be transferred to another company (referred to as the transferee company').

Section 394 (4) (b) makes it clear that:

- a 'transferor company' would mean any body corporate[8], whether or not a company registered under the Companies Act (i.e. an Indian company), implying that a foreign company could also be a transferor, and
- a 'transferee company' would only mean an Indian company.

[7] The High Court of each Indian State will usually designate a specific bench of the High Court as the Company Court, to which all such applications will be made. Upon the constitution and notification of the National Company Law Tribunal (NCLT), the competent authority for filing this application will be the NCLT and not the Company Court.

[8] A body corporate includes a company incorporated outside India, but excludes corporation sole, cooperative societies, and any other body corporate that may be notified by the Central Government.

Therefore, the Merger Provisions recognize and permit a merger/reconstruction where a foreign company merges into an Indian company. But the reverse is not permitted, and an Indian company cannot merge into a foreign company.

B. **<u>Securities Laws</u>**.

1. **Takeover Code**.

The Securities and Exchange Board of India (the "**SEBI**") is the nodal authority regulating entities that are listed on stock exchanges in India. The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 has been repealed by the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the "**Takeover Code**") with effect from October 23, 2011. The Takeover Code restricts and regulates the acquisition of shares, voting rights and control in listed companies. Acquisition of shares or voting rights of a listed company, entitling the acquirer to exercise 25% or more of the voting rights in the target company, obligates the acquirer to make an offer to the remaining shareholders of the target company to further acquire at least 26% of the voting capital of the company[9]. However, this obligation is subject to the exemptions provided under the Takeover Code. Exemptions from open offer requirement under the Takeover Code *inter alia* include acquisition pursuant to a scheme of arrangement[10]:

(i) involving the target company as a transferor company or as a transferee company, or reconstruction of the target company, including amalgamation, merger or demerger, pursuant to an order of a court or a competent authority under any law or regulation, Indian or foreign; or

(ii) arrangement not directly involving the target company as a transferor company or as a transferee company, or reconstruction not involving the target company's undertaking, including amalgamation, merger or demerger, pursuant to an order of a court or a competent authority under any law or regulation, Indian or foreign, subject to (a) the component of cash and cash equivalents in the consideration paid being less than twenty-five per cent of the consideration paid under the scheme; and (b) where after implementation of the scheme of arrangement, persons directly or indirectly holding at least thirty-three per cent of the voting rights in the combined entity are the same as the persons who held the entire voting rights before the implementation of the scheme.

Therefore if shares are acquired pursuant to a merger sanctioned by the Court under the Merger Provisions, the above mentioned conditions are fulfilled then the acquirer need not make an open offer for acquisition of additional shares under the Takeover Code.

<u>Disclosure requirements under the Takeover Code</u>.

Disclosures on specific acquisitions. Regulation 29(1) of the Takeover Code requires an acquirer to make disclosure of its aggregate shareholding in the target company if the acquirer acquires shares or voting rights which taken together with shares or voting rights, if any, held by him and by persons acting in concert ("**PAC**") with him in such target company, aggregate to five per cent or more of the shares of such target company.

Regulation 29(2) provides that an acquirer, who together with PAC, holds five per cent or more of the shares or voting rights in a target company, must disclose purchase or sale of 2% or more of the share capital or voting rights of the company. The disclosures mentioned above are to be made within 2 days of (i) the receipt of intimation of allotment of shares or (ii) the acquisition of shares or voting rights, as the case may be to the company and to the stock exchanges on which the shares of the company are listed.

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[9] Regulation 3 read with Regulation 7 of the Takeover Code.

[10] Regulation 10(1)(d).

Continual disclosures. Every person, who together with persons acting in concert with him, holds shares or voting rights entitling him to exercise twenty-five per cent or more of the voting rights in a target company, shall disclose their aggregate shareholding and voting rights as of March 31, to the company and to the stock exchanges on which the shares of the company are listed within seven working days from the end of each financial year.[11]

2. **Listing Agreement**.

The listing agreement[12] entered into by a company for the purpose of listing its shares with a stock exchange prescribes the following in the case of a Court approved scheme of merger/amalgamation/reconstruction:

- The scheme must be filed with the stock exchange at least one month prior to filing with the Court[13].
- The scheme cannot violate or override the provisions of any securities law/stock exchange requirements[14].
- The pre and post merger shareholding must be disclosed to the shareholders[15].
- An auditors' certificate to the effect that the accounting treatment contained in the scheme is in compliance with all the Accounting Standards specified by the Central Government in Section 211(3C) of the Companies Act, 1956 has to be compulsorily filed with the stock exchange[16].
- Any information on acquisition, merger, de-merger, amalgamation, restructuring, scheme of arrangement, spin off or selling divisions of the company, etc has to be forthwith made public by the company[17].
- Three copies of all notices (including for shareholder/ creditor meetings), circulars, advertisements etc., issued in connection with any merger, amalgamation, re-construction, reduction of capital, scheme or arrangement have to be promptly forwarded to the relevant stock exchange(s)[18].

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[11] Regulation 30(1).

[12] We refer to the Listing Agreement of the Bombay Stock Exchange as a standard since it is India's largest Stock Exchange.

[13] Clause 24(f) of the listing agreement

[14] Clause 24(g) of the listing agreement

[15] Clause 24(h) of the listing agreement

[16] Clause 24(i) of the listing agreement

[17] Clause 36(7) of the listing agreement

[18] Clauses 31 (c) and 31 (e) of the listing agreement

III. Acquisitions: Key Corporate and Securities Laws Considerations.

A. **<u>COMPANIES ACT, 1956.</u>**

The Companies Act does not make a reference to the term 'acquisition' *per se*. However, the various modes used for making an acquisition of a company involve compliance with certain key provisions of the Companies Act. The modes most commonly adopted are a share acquisition or an asset purchase.

1. **Acquisition of Shares**[19].

A share purchase may take place by an acquisition of all or some of the existing shares of the target by the acquirer, or by way of subscription to new shares in the target so as to acquire a controlling stake in the target.

<u>Transferability of shares</u>. Broadly speaking, an Indian company may be set up as a private company or a public company. Membership of a private company is restricted to 50 members[20], and a private company is required by the Companies Act to restrict the transferability of its shares. A restriction on transferability of shares is consequently inherent to a private company, such restrictions being contained in its articles of association (the byelaws of the company), and usually in the form of a pre-emptive right in favor of the other shareholders. The articles of association may prescribe certain procedures relating to transfer of shares that must be adhered to in order to affect a transfer of shares. While acquiring shares of a private company, it is therefore advisable for the acquirer to ensure that the non-selling shareholders (if any) waive any rights they may have under the articles of association, and the procedure for transfer under the articles of association is followed, lest any shareholder of the company claim that the transfer is void or claim a right to such shares.

<u>Transfer of shares</u>. The transferor and transferee are required to execute a share transfer form, and lodge such form along with the share certificates, with the company. The share transfer form is a prescribed form, which must be stamped in accordance with law. On lodging the same with the company, the company will affect the transfer in its records and endorse the share certificates in favor of the acquirer. It is also necessary for the Board of the company to pass a resolution approving the transfer of shares.

<u>Squeeze out provisions</u>.

It is permitted to squeeze out the minority shareholders in a company under the following modes:

(i) Scheme under section 395 of the Companies Act.

Section 395 of the Companies Act provides that if a scheme or contract involving the transfer of shares or a class of shares in a company (the 'transferor company') to another company (the 'transferee company') is approved by the holders of at least 9/10ths in value of the shares whose transfer is involved, the transferee company may give notice to the dissenting shareholders that it desires to acquire such shares, and the transferee company is then, not only entitled, but also bound to acquire such shares. In computing 90% (in value) of the shareholders as mentioned above, shares held by the acquirer, nominees of the acquirer and subsidiaries of the acquirer must be excluded.

If the transferee already holds more than 10% (in value) of the shares (being of the same class as those that are being acquired) of the transferor, then the following conditions must also be met:

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[19] Please note we have not addressed issues with respect to a non-Indian acquirer, which we have briefly addressed in our section on Exchange Control in Chapter V.

[20] Not including employees and former employees.

- The transferee offers the same terms to all holders of the shares of that class whose transfer is involved; and
- The shareholders holding 90% (in value) who have approved the scheme/contract should also be not less than 3/4ths in number of the holders of those shares (not including the acquirer).

The scheme or contract referred to above should be approved by the shareholders of the transferee company within 4 months from the date of the offer. The dissenting shareholders have the right to make an application to the Court within one month from the date of the notice, if they are aggrieved by the terms of the offer. If no application is made, or the application is dismissed within one month of issue of the notice, the transferee company is entitled and bound to acquire the shares of the dissenting shareholders.

The acquirer must send a copy of the notice (issued to the dissenting shareholders) along with an instrument of transfer, executed on behalf of the dissenting shareholder by any person appointed by the acquirer, to the target along with the consideration payable. The instrument of transfer must also be executed by the transferee on its own behalf.

The consideration received by the transferor must be deposited in a separate bank account and held in trust for the dissenting shareholders. This procedure is subject to the conditions and terms set forth in the Companies Act. The merit of these provisions is that a complete takeover or squeeze-out could be effected without resort to tedious court procedures.

Some restrictions: Section 395 provides that the "transferor company" (i.e. the target) can be any body corporate, whether or not incorporated under Indian law. Therefore the target can also be a foreign company. However, a 'transferee company' (i.e. the acquirer), must be an Indian company.

(ii) Scheme of capital reduction under section 100 of the Companies Act.

Section 100 of the Companies Act authorizes a Company to reduce its share capital and prescribes the procedure to be followed for the same. In reliance of sub-section (2) of Section 101 of the Companies Act, the Courts have laid down that a reduction of share capital need not necessarily be qua all the shareholders of the company.[21] Hence, selective capital reduction applicable only to few identified shareholders of the company including minority shareholders is permitted under the Companies Act.

The scheme of capital reduction under section 100 of the Companies Act has to be approved by, (i) the shareholders of the company *vide* a special resolution; and (ii) a competent court *vide* an order confirming the reduction.

Once the scheme is confirmed by the Court, the company has to register the scheme and the order with the relevant registrar of companies. Further, the company shall issue notices to the shareholders inviting applications for refund of the share capital and on receiving the applications the company shall credit the proportionate share capital to each of the shareholders in their respective accounts or pay the said amounts in cash.

The downside of this mode is that it is a court approved mechanism and could involve time constraints.

New share issuance. If the acquisition of a public company involves the issue of new shares or securities to the acquirer, then it would be necessary for the shareholders of the company to pass a special resolution under the provisions of Section 81(1A) of the Companies Act. A special resolution is one that is passed by at least 3/4ths of the shareholders present and voting at a meeting of the shareholders. A private company is not required to pass a special resolution for the issue of shares, and a simple resolution of the board of directors should suffice.

[21] Sandvik Asia Limited vs. Bharat Kumar Padamsi and Ors [2009]92SCL272(Bom); Elpro International Limited (2009 4 Comp LJ 406 (Bom))

The issue of shares by an unlisted public company to an acquirer must also comply with the Unlisted Public Companies (Preferential Allotment) Rules, 2003*.* Some of the important features of these rules are as follows:

- Equity shares, fully convertible debentures, partly convertible debentures or any other financial instruments convertible into equity are governed by these rules.

- The issue of shares must be authorized by the articles of association of the company and approved by a special resolution passed by shareholders in a general meeting, authorizing the board of directors of the company to issue the shares. The validity of the shareholders' resolution is 12 months, implying that if shares are not issued within 12 months of the resolution, the resolution will lapse, and a fresh resolution will be required for the issuance.

- The explanatory statement to the notice for the general meeting should contain key disclosures pertaining to the object of the issue, pricing of shares including the relevant date for calculation of the price, shareholding pattern, change of control, if any, and whether the promoters/directors/key management persons propose to acquire shares as part of such issuance.

<u>Limits on investment</u>. Section 372A of the Companies Act provides for certain limits on inter-corporate loans and investments. An acquirer may acquire by way of *subscription, purchase or otherwise*, the securities of any other body corporate up to 60% of the acquirers paid up share capital and free reserves, or 100 % of its free reserves, whichever is more. However, the acquirer is permitted to acquire shares beyond such limits, if it is authorized by its shareholders vide a special resolution passed in a general meeting. It may be noted that the restrictions under Section 372A are not applicable to private companies. Further, Section 372A would not be applicable to an acquirer which is a foreign company.

2. **Asset/ Business Purchase**.

An asset purchase involves the sale of the whole or part of the assets of the target to the acquirer. The board of directors of a public company or a private company which is a subsidiary of a public company, cannot sell, lease or dispose all, substantially all, or any undertaking of the company without the approval of the shareholders in a shareholders meeting. Therefore, it would be necessary for more than 50% of the shareholders of the seller company to pass a resolution approving such a sale or disposal. Further, a separate asset purchase agreement may sometimes be executed to better capture the provisions relating to transfer of assets. Non – compete provisions may also be linked to goodwill and contained in the asset purchase agreement.

B. **<u>SECURITIES LAWS</u>**

1. **Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009**

On August 26, 2009, Securities and Exchange Board of India ("**SEBI**") notified the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("**ICDR Regulations**") replacing the erstwhile Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000.

As per the ICDR Regulations, if the acquisition of an Indian listed company involves the issue of new equity shares or securities convertible into equity shares ("**Specified Securities**") by the target to the acquirer, the provisions of Chapter VII ("**Preferential Allotment Regulations**") contained in ICDR Regulations will be applicable (in addition to the provisions of the Companies Act mentioned above). We have highlighted below some of the relevant provisions of the Preferential Allotment Regulations.

Pricing of the issue.[22] Where the equity shares of the target have been listed on a stock exchange for a period of 6 months or more prior to the relevant date[23], the price of the equity shares issued on a preferential basis must be not less than the price that is the higher of, (a) the average of the weekly high and low of the closing prices of the related equity shares quoted on the stock exchange during the six months preceding the relevant date, or (b) the average of the weekly high and low of the closing prices of the related equity shares quoted on a stock exchange during the two weeks preceding the relevant date.

In case of preferential issue of equity shares, “relevant date”, shall be the date, thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue. For the purposes of preferential issue of convertible securities, “relevant date”, shall be either the date as mentioned above, or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

Lock-in. Specified Securities issued to the acquirer (who is not a promoter of the target) are subject to a lock-in for a period of one year from the date of allotment. Further, if the acquirer holds any equity shares of the target prior to such preferential allotment, then such prior equity shareholding of the acquirer shall be locked in for a period of 6 months from the date of the preferential allotment. If the Specified Securities are allotted on a preferential basis to promoters/promoter group as defined in Chapter I of the ICDR Regulations[24], these shall be locked in for a period of 3 years from the date of allotment subject to a permitted limit of 20% of the total capital of the company. Such locked in Specified Securities may be transferred amongst promoter/promoter group or any person in control of the company, subject to the transferee being subject to the remaining period of the lock in.

Currency of the resolution. The preferential allotment of Specified Securities pursuant to a resolution of the shareholders approving such issuance must be completed within a period of 15 days from the date on which the resolution is passed by the shareholders[25], failing which a fresh approval of the shareholders shall be necessary.

Exemption.[26] The Preferential Allotment Regulations do not apply in the case of a preferential allotment of shares pursuant to merger / amalgamation approved by the Court under the Merger Provisions discussed above.

2. **Takeover Code**.

Open offer requirement. If an acquisition is contemplated by way of issue of new shares[27], or the acquisition of existing shares, of a listed company, to or by an acquirer, the provisions of the Takeover Code may be applicable. Under the Takeover Code, an acquirer, along with persons acting in concert[28]:

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[22] Regulation 76(1) of the ICDR Regulations.

[23] The relevant date, for preferential issues of equity shares, is the date thirty days prior to the date on which the general meeting of the shareholders is held to approve the proposed issue of shares. In case of preferential issue of convertible securities, either the date mentioned aforesaid or the date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

[24] The terms ‘promoter’ and ‘promoter group’ are defined in great detail by the Regulations, Generally speaking, promoters would be the persons in over-all control of the company or who are named as promoters in the prospectus of the company. The term promoter group has an even wider connotation and would include immediate relatives of the promoter. If the promoter is a company, it would include, a subsidiary or holding company of that company, any company in which the promoter holds 10% or more of the equity capital or which holds 10% or more of the equity capital of the promoter, etc.

[25] Regulation 74(1). If allotment of shares is pending on account of any approval required from a government /regulatory authority then the allotment must be completed within 15 days from the date of such approval.

[26] Regulation 70(1)

- cannot acquire shares or voting rights which (taken together with shares or voting rights, if any, held by him and by persons acting in concert), entitle such acquirer to exercise 25% or more of the shares or voting rights in the target[29],

- who has acquired, 25% or more but less than 75% of the shares or voting rights in the target, cannot acquire, either by himself or through persons acting in concert, additional shares or voting rights entitling him to exercise more than 5% of the voting rights the target, in any financial year.[30]

unless the acquirer makes a public announcement to acquire the shares or voting rights of the target in accordance with the provisions of the Takeover Code. The term 'acquisition' would include both, direct acquisition in an Indian listed company as well as indirect acquisition of an Indian listed company by virtue of acquisition of companies, whether listed or unlisted, whether in India or abroad. Further, the aforesaid limit of 5% acquisition is calculated aggregating all purchases, without netting of sales.

The definition of "shares" under Regulation 2 (1)(v) of the Takeover Code specifically include all depository receipts carrying an entitlement to exercise voting rights in the target company in the definition of shares. Therefore acquisition of depository receipts entitling the acquirer to exercise voting rights in the target company beyond the prescribed thresholds can trigger the open offer obligation.

Regulation 4 of the Takeover Code further provides that irrespective of whether or not there has been any acquisition of shares or voting rights in a company, no acquirer shall acquire, directly or indirectly, control[31] over the target company, unless such person makes a public announcement to acquire shares and acquires such shares in accordance with the Takeover Code.

The Takeover Code regulates both direct and indirect acquisitions of shares or voting rights in, and control over the target company.

The principle objectives of the Takeover Code are to provide the shareholders of a listed company with adequate information about an impending change in control of the company, and also to provide them with a limited exit option in case they do not wish to retain their shareholding in the company post the change in control. It is also possible for the acquirer to provide that the offer to acquire shares is subject to minimum level of acceptance, which may be less than 26%. However to do this, the acquirer would need to deposit at least 50% of the consideration payable in an escrow account.

<u>Voluntary offer</u>. Any acquirer whose shareholding/ voting rights in a company is between 25% and 75% is permitted to voluntarily make a public announcement of an open offer for acquiring additional shares of the

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[27] "shares" means shares in the equity share capital of a target company carrying voting rights and includes any security which would entitles the holder thereof to exercise voting rights;

[28] See Annexure 2

[29] Regulation 3 (1) of the Takeover Code

[30] Regulation 3 (2) of the Takeover Code

[31] The definition of the term 'control' in the Takeover Code is very wide and encompasses every possible method of gaining control. Regulation 2 (1) (c) defines 'control' to include the right to appoint majority of the 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. Provided that a director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position;

company subject to their aggregate shareholding after completion of the open offer not exceeding 75%.[32] However, if such acquirer or any person acting in concert with him has acquired shares of the target company in the preceding fifty-two weeks without attracting the obligation to make a public announcement of an open offer then he shall not be eligible to voluntarily make an open offer.

Any acquirer making voluntary open offer shall not be entitled to (i) acquire any shares otherwise than under the open offer during the offer period; and (ii) acquire any shares of the target company for a period of six months after completion of the open offer except pursuant to another voluntary open offer or a competing offer.

Any person who holds less than 25% shares/ voting rights in a target company or no shares/ voting rights in a target company is also permitted to make a public offer to acquire the shares/ voting rights of the target company provided the minimum offer size is 26% of the paid up share capital of the target company. In that case, the restrictions prescribed under the Takeover Code for a "voluntary offer" made by a shareholder whose shareholding is between 25% and 75% of share capital of target company are not applicable.

<u>Pricing of the offer</u>.

The offer price shall be the highest of:[33]

a. the highest negotiated price per share of the target company under the agreement triggering the open offer;

b. the volume-weighted average price paid or payable for acquisitions, by the acquirer or person acting in concert with him, during the fifty-two weeks immediately preceding the date of the public announcement;

   In case of indirect acquisition the fifty-two weeks immediately preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain shall be considered;

c. the highest price paid or payable for any acquisition, by the acquirer or by any person acting in concert with him, during the twenty-six weeks immediately preceding the date of the public announcement;

   In case of indirect acquisition the twenty-six weeks immediately preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain shall be considered;

d. the volume-weighted average market price of such shares for a period of sixty trading days immediately preceding the date of the public announcement as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, provided such shares are frequently traded;

   In case of indirect acquisition the sixty trading days immediately preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain shall be considered;

e. the per share value computed for any indirectly acquired target company in cases where the proportionate net asset value, proportionate sales turnover and proportionate market capitalization of the indirectly acquired target company as a percentage respectively, of the consolidated net asset value consolidated

[32] Regulation 6 (1) of the Takeover Code.

[33] Regulation 8 of the Takeover Code.

sales turnover and the enterprise value entity or business being directly acquired is in excess of fifteen per cent, on the basis of the most recent audited annual financial statements.

f. where the shares are not frequently traded, the price determined by the acquirer and the manager to the open offer taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies; and

In case of indirect acquisition, (f) above shall not be considered to determine the offer price and instead the following parameter will be considered:

"the highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, between the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain, and the date of the public announcement of the open offer for shares of the target company made under these regulations".

Mode of payment of offer price. The offer price may be paid in cash, listed shares of the acquirer or PAC; listed secured debt instruments issued by the acquirer or PAC with a rating not inferior to investment grade as rated by a credit rating agency registered with the Board; convertible debt securities entitling the holder thereof to listed equity shares of the acquirer or PAC or combination of any of the above.[34]

If the acquirer intends to dispose of / encumber the material assets of the target company or its subsidiaries, a disclosure to that effect must be made in the detailed public announcement and in the letter of offer to the shareholders, failing which, the acquirer cannot dispose of or encumber the assets of the target company for a period of 2 years from the date of closure of the public offer except in the ordinary course of business or with a special resolution passed by shareholders of the target company approving such sale/ encumbrance.[35]

Restrictions on the target company. During the offer period, the target company is subject to certain restrictions *inter alia* as provided herein below:[36]

a. The target company cannot sell, transfer, lease, encumber or otherwise dispose off or enter into an agreement for sale, transfer, encumbrance or for disposal of material assets, except in the ordinary course of business of the target company and its subsidiaries,

b. The target company cannot issue or allot any authorized but unissued securities carrying voting rights during the offer period, except(i) on conversion of convertible securities issued prior to the public announcement; (ii) pursuant to any public issue in respect of which the red herring prospectus has been filed with the Registrar of Companies; and (iii) pursuant to any rights issue in respect of which the record date has been announced prior to the public announcement.

c. The target company cannot effect any material borrowings outside the ordinary course of business; and

d. The target company cannot enter into, amend or terminate any material contracts.

Further the board of directors of the target company cannot (a) appoint as additional director or fill in any casual vacancy on the board of directors, any person(s) representing the acquirer or PAC, until the expiry of a period of fifteen working days from the date of detailed public statement and the acquirer deposits the escrow amount

[34] Regulation 9 (1)

[35] Regulation 25 (2)

[36] Regulation 26.

prescribed under the Takeover Code, and (b) permit any existing director of the target company who represents the acquirer or PAC, to participate in any matter relating to the offer.[37]

Competitive Bid/ Revision of offer/bid. The Takeover Code also permits a person other than the acquirer (the first bidder) to make a competitive bid, by a public announcement, for the shares of the target company. This bid must be made within 15 working days from the date of the detailed public announcement of the first bidder. The competitive bid must be for at least the number of shares held or agreed to be acquired by the first bidder (along with PAC), plus the number of shares that the first bidder has bid for. Pursuant to a competing bid, the first bidder is permitted to revise his bid, provided such revised terms are more favourable to the shareholders of the target company.[38]

The first bidder (and any other bidder) is in fact, entitled to revise his offer price upwards at any time up to three working days prior to the commencement of the tendering period, irrespective of whether or not a competitive bid is made.

Certain exemptions from the applicability of the Regulations 3 and 4 of the Takeover Code.[39] The following acquisitions / transfers would be exempt from the open offer requirement under the Takeover Code:

- acquisition pursuant to a public issue;
- acquisition by a shareholder whose shareholding is between 25% to 75% of the voting rights, pursuant to a rights issue to the extent of his entitlement and beyond his entitlement subject to certain other restrictions;
- inter-se transfer of shares amongst "qualifying persons"[40] subject to prescribed conditions;
- acquisition of voting rights or preference shares carrying voting rights arising out of the operation of sub-section (2) of section 87 of the Companies Act, 1956 (1 of 1956)
- acquisition of shares by a person whose shareholding in the target is between 25% to 75% of the voting rights, in exchange of shares received under a public offer made under the Takeover Code;
- acquisition of shares by way of transmission on succession or inheritance;
- transfer of shares from venture capital funds or foreign venture capital investors registered with the SEBI to promoters of a venture capital undertaking or to a venture capital undertaking, pursuant to an agreement between such venture capital fund or foreign venture capital investors, with such promoters or venture capital undertaking;
- acquisition of shares in a target company from state-level financial institutions or their subsidiaries or companies promoted by them, by promoters of the target company pursuant to an agreement between such transferors and such promoter
- acquisition pursuant to the provisions of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
- acquisition pursuant to the provisions of the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009.
- acquisition of shares in the ordinary course of business *inter alia* by (a) banks and public financial institutions as pledgees, (b) an underwriter registered with the Board by way of allotment pursuant to an underwriting agreement in terms of ICDR Regulations, and (c) a stock broker registered with the Board on behalf of his client in exercise of lien over the shares purchased on behalf of the client;
- Increase in voting rights pursuant to buy-back of shares as provided below[41]:

[37] Regulation 24.

[38] Regulation 20.

[39] Please note that the list of exemptions provided is not exhaustive.

[40] Please refer to Annexure 2 hereto.

[41] Regulation 10(3) read with Regulation 10(4)(c).

a. Increase in voting rights above 25%, provided such shareholder reduces his voting rights below 25% of the voting rights within ninety days from the date on which the voting rights so increase; and

b. Increase in voting rights of a shareholder holding voting rights between 25% and 75% beyond 5% in a financial year provided (1) the shareholder reduces his voting rights below the threshold within ninety days from the date on which the voting rights so increase and (2) shareholder complies with other prescribed conditions.

3. **Listing Agreement.**

Clause 40A of the listing agreement[42] entered into by a company with the stock exchange on which its shares are listed, requires the company to maintain a public shareholding[43] of at least 25% on a continuous basis. If the public shareholding falls below the minimum level pursuant to:

- the issuance or transfer of shares (i) in compliance with directions of any regulatory or statutory authority, or (ii) in compliance with the Takeover Code, or
- reorganization of capital by a scheme of arrangement,

the stock exchange may provide additional time of 1 year (extendable upto to 2 years) to the company to comply with the minimum requirements. In order to comply with the minimum public shareholding requirements, the company must either, issue shares to the public or offer shares of the promoters to the public. If a company fails to comply with the minimum requirements, its shares may be delisted by the stock exchange, and penal action may also be taken against the company.

4. **Insider Trading Regulations.**

Securities and Exchange Board of India (Insider Trading) Regulations, 1992 regulates insider trading and a person in violation of these regulations is punishable under Section 24 and Section 15G of the SEBI Act, 1992. These regulations were considerably amended in 2002 and renamed as Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 (hereinafter referred to as the "**SEBI Insider Regulations**"). The SEBI Insider Regulations are intended to prevent insider trading in securities of Indian listed company. The SEBI Insider Regulations are basically punitive in nature with respect to describing what constitutes insider trading and then seeking to punish such an act in various ways. SEBI is responsible for administering and enforcing SEBI Insider Regulations.

Regulation 3 of SEBI Insider Regulations prohibits an Insider from communicating counseling or procuring directly or indirectly any unpublished price sensitive information to any person. Thus, the above provisions prohibit the insider from communicating unpublished price sensitive information and also the person receiving such unpublished price sensitive information from dealing in securities. As defined under the Regulation 2(d), the words "dealing in securities" "shall mean the act of subscribing, buying, selling, or agreeing to subscribe, buy or sell or deal in any securities by any person, either as principal or as agent.

As per Regulation 2(ha) of SEBI Insider Regulations, price sensitive information ("**PSI**") means:

"*any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company*".

[42] We refer to the Listing Agreement of the Bombay Stock Exchange as a standard since it is India's largest Stock Exchange.

[43] Public shareholding excludes shares held by the promoter group and held by custodians against which depositary receipts are issued overseas.

Therefore, any information which can materially affect the price of securities could be treated as PSI. The following shall be deemed to be PSI [44]:

- Periodical financial results of the company;
- Intended declaration of dividends (both interim and final);
- Issue of securities or buy-back of securities;
- Any major expansion plans or execution of new projects;
- Amalgamation, mergers or takeovers;
- Disposal of the whole or substantial part of the undertaking; and
- Significant changes in policies, plans or operations of the company.

Information that is not publicly known or information that has not been published officially is considered as non public information. The term "unpublished" is defined under Regulation 2(k) of the SEBI Insider Regulations as "information which is not published by the company or its agents and is not specific in nature[45]".

Under the SEBI Insider Regulations, an insider on his behalf or on behalf of any other person is prohibited from dealing in securities of a company listed on a stock exchange when he is in possession of any Unpublished PSI, irrespective of whether or not such a trade was made for the purpose of making a gain or reducing a loss. As such, the existence of profit motive is not required while interpreting the violation of SEBI Insider Regulations. However, in the case of Rakesh Agarwal v. SEBI[46], it was held that if an insider based on the Unpublished PSI deals in securities for no advantage to him, over others, it is not against the interest of shareholders. Further it was held that it is true that the regulation does not specifically bring in mens rea as an ingredient of insider trading. But that does not mean that the motive need be ignored.

Regulation 3 of the SEBI Insider Regulations prohibits dealing, communication or counseling on matters relating to insider trading. It states that, "No insider shall

i) "either on his own behalf or on behalf of any other person, deal in securities of a company listed on any stock exchange when in possession of any unpublished price sensitive information; or

ii) communicate counsel or procure directly or indirectly any unpublished price sensitive information to any person who while in possession of such unpublished price sensitive information shall not deal in securities:

Provided that nothing contained above shall be applicable to any communication required in the ordinary course of business or profession or employment or under any law."

On the basis of this regulation it may be stated that the offence of insider trading or dealing, constitutes of a set of necessary ingredients, which are:

- Involvement of Insiders / Connected persons;
- Possession of unpublished Price Sensitive Information; and
- Dealing in securities listed on any stock exchange.

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[44] Regulation 2(ha) Explanation, SEBI Insider Regulations.

[45] Speculative reports in print or electronic media shall not be considered as published information.

[46] [2004] 49 SCL 351 (SAT- Mumbai)

Regulation 3A reads, "No company shall deal in the securities of another company or associate of that other company while in possession of any unpublished price sensitive information".

Disclosure Requirements. Previously, the SEBI Insider Regulations required all the directors, officers and substantial shareholders in a listed company to make periodic disclosures of their shareholding as specified in the SEBI Insider Regulations. SEBI *vide* its notification dated 16 August, 2011 amended Regulation 13 of the Insider Trading Regulations and in pursuance thereof the 'promoters' and members of 'promoter group' have been brought within the purview of the said regulations.

Initial Disclosures.[47] Any person holding more than 5% shares or voting rights in any listed company is required to disclose to the company in Form A[48], the number of shares or voting rights held by such person on becoming such holder, within two (2) working days of the receipt of intimation of allotment of shares or the acquisition of shares or voting rights, as the case may be. Any person, who is a director or officer or promoter or member of promoter group of a listed company, shall disclose to the company in Form B[49], the number of shares or voting rights held by such person and their dependents within two working days of becoming a director or officer of the company.

Continual Disclosures.

- Any person holding more than 5% shares or voting rights in any listed company is required to disclose to the company within two (2) working days from receipt of intimation of allotment of shares; or acquisition or sale of shares or voting rights in Form C[50], the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below 5%, if there has been any change in such holdings from the last disclosure made under Regulation 13(1) of SEBI Insider Regulations or under this sub-regulation and such change exceeds 2% of total shareholding or voting rights in the company.

- Any person, who is a director or officer or promoter or member of promoter group of a listed company, shall disclose to the company in Form D[51], the change in shareholding or voting rights held by him and his dependents, if the change exceeds INR 5 lacs in value or 25,000 shares or 1% to total shareholding or voting rights, whichever is lower. The disclosure shall be made within two (2) working days from receipt of intimation of allotment of shares or acquisition or sale of shares or voting rights.

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[47] Regulation 13, SEBI Insider Regulations.

[48] Schedule III, Form A, SEBI Insider Regulations.

[49] Schedule III, Form B, SEBI Insider Regulations.

[50] Schedule III, Form C, SEBI Insider Regulations.

[51] Schedule III, Form D, SEBI Insider Regulations.

IV. Competition Law

In India, the Monopolies and Restrictive Trade Practices Act, 1969 ("**MRTP**") was the first enactment that came into effect on June 1, 1970 with the object of controlling monopolies, prohibiting monopolistic and restrictive trade practices and unfair trade practices. The commission set up under the MRTP was empowered to inquire into any practice in relation to goods or services which are monopolistic, restrictive or unfair in nature. The complaint may be preferred by a consumer, trade or consumer association or even the Central Government. The commission was armed with powers to pass orders for the discontinuation of the practice. Where the inquiry by the commission reveals that the trade practice inquired into operates or is likely to operate against public interest, the Central Government may pass such orders as it thinks fit to remedy or present any mischief resulting from such trade practice. Prior to 1991, the MRTP also contained provisions regulating mergers and acquisitions. In 1991, the MRTP was amended, and the provisions regulating mergers and acquisitions were deleted. With the changing nature of competition laws, a need was felt for a change in focus, with emphasis on promoting competition rather than curbing monopolies.

Thereafter, Government of India appointed a committee in October, 1999 to examine the existing MRTP Act for shifting the focus of the law from curbing monopolies to promoting competition and to suggest a modern competition law.

The Government of India enacted the Competition Act, 2002 ("**Competition Act**") to replace the existing MRTP. Vide a notification dated August 28, 2009, Section 66 of the Competition Act has been brought into force by virtue of which the MRTP Act was repealed with effect from September 1, 2009. However, the jurisprudence of the MRTP regime while interpreting the substantive provisions of MRTP Act may be of persuasive value while interpreting the substantive provisions of the Competition Act. Please refer to **Annexure 3** for FAQs on the Competition Act.

The Competition Act takes a new look at competition altogether and contains specific provisions on anti-competition agreements, abuse of dominance, mergers, amalgamations and takeovers and competition advocacy. The Competition Commission of India ("**CCI**") has been established to control anti-competitive agreements, abuse of dominant position by an enterprise and for regulating certain combinations. The substantive provisions of the Competition Act relating to anti competitive agreements (Section 3), abuse of dominance (Section 4), and provisions relating to combinations (Section 5, 6, 20, 29, 30 and 31) have been notified and brought into effect.

Further, CCI on May 11, 2011 issued the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 ("**Combination Regulations**"). These Combination Regulations will now govern the manner in which the CCI will regulate combinations which have caused or are likely to cause appreciable adverse effect on competition in India ("**AAEC**").

A. ANTI COMPETITIVE AGREEMENTS.

The Competition Act essentially contemplates two kinds of anti competitive agreements – horizontal agreements or agreements between entities engaged in similar trade of goods or provisions of services, and vertical agreements or agreements between entities in different stages / levels of the chain of production, in respect of production, supply, distribution, storage, sale or price of goods or services. Anti competitive agreements that cause or are likely to cause an *appreciable adverse effect on competition within India* are void under the provisions of the Competition Act. A horizontal agreement that (i) determines purchase / sale prices, or (ii) limits or controls production supply, markets, technical development, investment or provision of services, or (iii) shares the market or source of production or provision of services, by allocation of geographical areas/type of goods or services or number of customers in the market, or (iv) results in bid rigging / collusive bidding, are *presumed to have an appreciable adverse effect on competition*. On the other hand, vertical agreements, such as tie-in arrangements[52], exclusive supply or distribution agreements, etc., are anti competitive only if *they cause or are likely to cause an appreciable adverse effect on competition in India*.

It may be noted that in the case of a vertical agreement, there is no presumption that such agreement would have an appreciable adverse effect on competition in India, and the CCI would have to prove such effect. However, in the case of a horizontal agreement, the burden of proof would lie with the entities who are party to the agreement, to prove that there is no appreciable adverse effect on competition in India.

B. **ABUSE OF DOMINANT POSITION.**

An entity is considered to be in a dominant position if it is able to operate independently of competitive forces in India, or is able to affect its competitors or consumers or the relevant market in India in its favor. The Competition Act prohibits an entity from abusing its dominant position. Abuse of dominance would include imposing unfair or discriminatory conditions or prices in purchase/sale of goods or services and predatory pricing, limiting or restricting production / provision of goods/services, technical or scientific development, indulging in practices resulting in denial of market access etc.

C. **REGULATION OF COMBINATIONS.**

The Combination Regulations have come into effect from June 1, 2011 to supplement Sections 5 and 6 of the Competition Act. With the publication of these Combination Regulations, the CCI has been finally saddled with all the powers required to act as an economic regulator and exercise 'merger-control' over the Indian soils. The effects of the enactment of the Combination Regulations are vast since under Section 32 of the Competition Act, the CCI has been conferred with extra-territorial jurisdiction to fulfill its mandate of eliminating practices having AAEC. What this means is that every acquisition that involves the acquirer or the target, wherever incorporated having assets or a turnover in India in excess of the prescribed limits may be subject to scrutiny by the CCI.

"Combination", for the purposes of the Competition Act means:

a. an acquisition of control, shares or voting rights or assets by a person;

b. an acquisition of control of an enterprise where the acquirer already has direct or indirect control of another engaged in identical business; or

c. a merger or amalgamation between or among enterprises;

that exceed the 'financial thresholds' prescribed under the Competition Act.

Financial thresholds. 'Financial thresholds' prescribed under the Competition Act for determining 'combinations' are as follows:

- An acquisition/ merger where the transferor and transferee jointly have, or a merger or amalgamation where the resulting entity has, (i) assets valued at more than INR 15 billion or turnover of more than INR 45 billion, in India; or (ii) assets valued at more than USD 750 million in India and abroad, of which assets worth at

[52] A tie-in arrangement would include any agreement requiring a purchaser of goods, as condition of such purchase to purchase some other goods. A classic example of this on a global scale may be Microsoft's bundling of its web browser Internet Explorer along with the Windows operating system, limiting Netscape's web browser, Navigator, from having a significant presence in the market.

least Rs 7.5 billion are in India, or, turnover more than USD 2250 million of which turnover in India should be at least Rs 22.5 billion.

- An acquisition/ merger where the group to which the acquired entity would belong, jointly has, or a merger or amalgamation where the group to which the resulting entity belongs, has (i) assets valued at more that INR 60 billion or turnover of more than Rs 180 billion, in India; or (ii) assets valued at more than USD 3 billion in the aggregate in India and abroad, of which assets worth at least Rs 7.5 billion should be in India, or turnover of more than USD 9 billion, including at least Rs 22.5 billion in India

Pre-Filing Consultation. Any enterprise which proposes to enter into a combination may request in writing to the CCI, for an informal and verbal consultation with the officials of the CCI about filing such proposed 'combination' with CCI. Advice provided by the CCI during such pre-filing consultation is not be binding on the CCI.

Mandatory reporting. Section 6 makes void any combination which causes or is likely to cause an AAEC on competition within India. Accordingly, Section 6 of the Act requires every acquirer to notify the CCI of a combination within 30 days of the decision of the combination or the execution of any agreement or other document for acquisition and seek its approval prior to effectuating the same.

The Combinations Regulations mandate CCI to form a *prima facie* opinion on whether a combination has caused or is likely to cause an AAEC within the relevant market in India, within 30 days of filing. The combination will become effective only after the expiry of 210 days from the date on which notice is given to the CCI, or after the CCI has passed an order approving the combination or rejecting the same.

Single notification involving multiple tranches. The Combination Regulations clearly stipulate that where the ultimate intended effect of a business transaction is achieved by way of a series of steps or smaller individual transactions which are inter-connected or inter-dependent on each other, one or more of which may amount to a combination, a single notice, covering all these transactions, may be filed by the parties to the combination.

Exempt enterprises. An enterprise whose shares, control, voting rights or assets are being acquired has assets of the value of not more than INR 250 crores (approx. USD 56 million) in India or turnover of the value of not more than INR 750 crores (approx. USD 160 million) in India is exempt from the provisions of Section 5 of the Competition Act till March 4, 2016.[53]

Exceptions to filing. Deviating from the strict interpretation of Section 6 of the Competition Act, which requires all combinations to be notified to the CCI, Schedule I to the Combination Regulations specifies certain categories of transactions which are *ordinarily* not likely to have an AAEC and therefore would not *normally* require to be notified to the CCI which *inter alia* include:

- Acquisitions of shares or voting rights as an investment or as an investment in so far as the total shares or voting rights held by the acquirer directly or indirectly does not exceed 15% of the total shares or voting rights of the company.

- Consolidation of holdings in an entity where the acquirer already had 50% or more shares or voting rights except in cases where the transaction results in a transfer from joint control to sole control.

- An acquisition of assets unrelated to the business of the acquirer other than an acquisition of a substantial business operation.

- Acquisitions of stock-in-trade, raw materials, stores, current assets (in the ordinary course of business).

[53] http://www.cci.gov.in/images/media/notifications/SO479(E),480(E),481(E),482(E)240611.pdf

- Acquisitions of bonus or rights shares, not leading to acquisition of control.

- Combinations taking place entirely outside India with insignificant local nexus and effect on markets in India.

Impact on transactions involving listed companies. In combination involving listed companies, a primary transaction may trigger notification with CCI and subsequent open offer obligation under the Takeover Code. This means that the primary transaction or the open offer cannot be effected unless clearance from the CCI is obtained. In cases where clearance from the CCI is not received within the statutory time period required to complete the open offer as prescribed under the Takeover Regulations, then as per the extant provisions of the said Takeover Code, the acquirer has to pay interest to shareholders for delay beyond the statutory period required to complete payment to the tendering shareholders on account of non-receipt of statutory approvals.

A share subscription, financing facility or any acquisition by a public financial institution, FII, bank or venture capital fund pursuant to any loan or investment agreement, would not qualify as a combination that will be regulated by the CCI, and such transactions are therefore exempt under the Competition Act. However, the public financial institution, FII, bank or venture capital fund is required to notify the CCI of the details of the acquisition within 7 day of completion of the acquisition.

V. Exchange Control

A. Foreign Direct Investment

India's story with respect to exchange control is one of a gradual, deliberate and carefully monitored advance towards full capital account convertibility. Though significant controls have been removed and foreign companies can freely acquire Indian companies across most sectors, these are subject to strict pricing and reporting requirements imposed by the central bank, the Reserve Bank of India ("**RBI**"). Investments in, and acquisitions (complete and partial) of, Indian companies by foreign entities, are governed by the terms of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 (the "**FDI Regulations**") and the provisions of the Industrial Policy and Procedures issued by the Secretariat for Industrial Assistance (SIA) in the Ministry of Commerce and Industry, Government of India.

Automatic Route. Schedule 1 of the FDI Regulations contains the Foreign Direct Investment Scheme ("**FDI Scheme**"), which permits a non-resident to acquire shares or convertible debentures[54] in an Indian company upto the investment (or sectoral) caps for each sector provided in Annexure B to the FDI Scheme. Investment under the FDI Scheme is generally referred to as an investment under the 'automatic route' as no permissions or approvals are necessary. Part A of Annexure A to the FDI Scheme lists the activities for which general permission is not available for a non-resident, which include activities such as defense, print media, broadcasting, postal services, courier services etc. Investment in these sectors requires the prior approval of the Foreign Investment Promotion Board ("**FIPB**") of the Government of India, which is granted on a case to case basis. Part B of Annexure A lists the sectors in which foreign direct investment is prohibited, namely, retail trading, atomic energy, lottery business, gambling and betting, housing and real estate[55]. All investments that require prior FIPB approval and are beyond INR 1,200 crores (i.e. INR 12 Billion) require a prior approval of the Cabinet Committee on Economic Affairs.

Indirect Foreign Investment. Foreign direct investment may be direct or indirect. If an Indian investing company is "owned"[56] or "controlled"[57] by "non-resident entities"[58], then the entire investment by the investing company into the subject downstream Indian investee company would be considered as indirect foreign investment. Provided that, as an exception, the indirect foreign investment in wholly owned subsidiaries of operating-cum-investing/investing companies will be limited to the foreign investment in the operating-cum-investing/ investing company. The exception was made since the downstream investment of a 100% owned subsidiary of the holding company is akin to investment made by the holding company and the downstream investment should be a mirror image of the holding company.

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[54] A foreign investor may also subscribe to preference shares. However, in order to fall under the automatic route, the preference shares / debentures must be compulsorily convertible into equity, failing which the investment will be treated as a debt and the External Commercial Borrowings (ECB) policy will be applicable.

[55] Investment in real estate is permitted subject to compliance with certain conditions such as minimum capitalization, minimum area of construction etc. (refer Press Note 2 of 2005 issued by the Government of India).

[56] "owned" by resident Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens, if more than 50% of the equity interest in it is beneficially owned by resident Indian citizens and Indian companies, which are owned and controlled ultimately by resident Indian citizens.

[57] "controlled" by resident Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens, if the resident Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens, have the power to appoint a majority of its directors.

[58] "Non-resident entity" means a 'person resident outside India' as defined under FEMA 1999.

Downstream Investment. Foreign investment, whether direct or indirect, into a company that is not operational shall require prior approval of the Government of India / FIPB.

Portfolio Investment Scheme. Foreign institutional investors ("**FII**") registered with the SEBI and non-resident Indians ("**NRI**"), are permitted to invest in shares / convertible debentures under the portfolio investment scheme. This scheme permits investment in listed securities through the stock exchange.

Foreign venture capital investors ("**FVCI**"). An FVCI registered with the SEBI can invest in Indian venture capital undertakings, venture capital funds or in schemes floated by venture capital funds under the terms of Schedule 6 of the FDI Regulations. One of the important benefits of investing as an FVCI is that an FVCI is not required to adhere to the pricing requirements that are otherwise required to be met by a foreign investor under the automatic route when purchasing or subscribing to shares or when selling such shares.

Acquisition of rights shares/ bonus shares. A non-resident may subscribe to shares issued on a rights basis by an Indian company provided that the offer of shares does not result in increase in the percentage of foreign equity permitted for such company, and the price at which the shares are offered to the non-resident is not less than the price offered to the resident shareholders. A non-resident may also acquire bonus shares under the FDI Regulations. The rights/bonus shares will however be subject to the same conditions as those applicable to the original shares.

Issue of Shares under merger/ amalgamation / demerger. A transferee company may issue shares to the shareholders of a transferor company under a scheme of merger or amalgamation approved by an Indian court, provided that the sectoral caps mentioned above are not exceeded.

Issue of shares against import of capital goods and pre-operative/pre-incorporation expenses. Indian companies can issue and allot equity shares/ preference shares to a person resident outside India under the automatic route against Import of capital goods/ machineries / equipments (including second-hand machineries) and Pre-operative/pre-incorporation expenses (including payments of rent, etc.) subject to compliance with the conditions prescribed.[59]

Pricing under the automatic route. Acquisition of shares of an Indian company by a person resident outside India under the automatic route may only be made in accordance with the pricing requirements provided in the FDI Regulations. The price of shares issued to non-residents cannot be less than the fair value of the shares as determined by the by the discounted cash flows valuation of the issuing company, or if the Indian company is listed, the price cannot be less than the price calculated in accordance with the SEBI guidelines.

Foreign Technology Collaborations. Payments for foreign technology collaboration by Indian companies are allowed under the automatic route subject to compliance without any limits.

Existing joint ventures. Previously, foreign investors who had any existing joint venture or technology transfer/trade-mark agreement in India could make further foreign investment in another project in the same or allied field only with prior government approval. However, this requirement has been done away with now.

ADR/GDR. An Indian company may also issue American Depositary Receipts / Global Depositary Receipts to foreign investors in accordance with the scheme for Issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depositary Receipt Mechanism) Scheme, 1993.

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[59] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/1CAP74300611.pdf

B. **<u>OVERSEAS DIRECT INVESTMENT.</u>**

An Indian company that wishes to acquire or invest in a foreign company outside India must comply with the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 (the "**ODI Regulations**").

The ODI Regulations are an extension of the process of liberalization initiated by the Government of India in the late 1990s. The regulations contain detailed provisions governing investments made by an Indian company in a foreign company by grant of 'general permission' to make a 'direct investment outside India' in *bona fide* business activities, subject to compliance with the regulations. The term 'direct investment outside India' has been defined as '*investment by way of contribution to the capital or subscription to the Memorandum of Association of a foreign entity or by way of purchase of existing shares of a foreign entity either by market purchase or private placement, or through stock exchange, but does not include portfolio investment*'. An Indian company is not permitted to make any direct investment in a foreign entity engaged in real estate business or banking business without the prior approval of the RBI[60].

The Indian party may choose to fund the aforesaid investment out of balances held in the EEFC account, by way of drawing funds from an authorized dealer subject to certain limits, or using the proceeds of an ADR/GDR issue. There are several routes available to an Indian company which intends to invest in a foreign company. The key routes normally utilized in such transactions are described below:

1. Direct Investment in a Joint Venture/Wholly Owned Subsidiary

An Indian company is permitted to invest in a joint venture ("**JV**") or a wholly owned subsidiary ("**WOS**") of upto 400 %[61] of the net worth of the Indian company as on the date of the last audited balance sheet without seeking the prior approval of the RBI, subject to the following conditions being fulfilled:

1. The Indian company is not on the RBI's caution list or under investigation by the Enforcement Directorate.
2. The Indian company routes all the transactions relating to the investment in the JV or the WOS through only one branch of an authorized dealer to be designated by it.
3. The Indian company files the prescribed forms with the RBI.

<u>Investment in company listed overseas</u>. A person resident in India (being an individual or a listed Indian company) may invest in an overseas company listed on a recognized stock exchange, or in rated bonds or fixed income securities issued by a listed company. If the investment is made by an Indian listed company, the quantum of investment is limited to 50% of the net worth of such Indian company as on the date of its last audited balance sheet.

<u>Investment by mutual funds</u>. Mutual funds registered with the SEBI, are permitted to invest in securities of a listed overseas entity[62]. The various kind of securities in which mutual funds are permitted to invest, are:

i) ADRs / GDRs issued by Indian or foreign companies;

ii) equity of overseas companies listed on recognized stock exchanges overseas;

iii) initial and follow on public offerings for listing an recognized stock exchanges overseas;

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[60] Although banking business is a prohibited business under the ODI regulations, Indian banks can set up JVs/WOSs abroad provided they obtain approval from the RBI under the ODI regulations and also under the Banking Regulation Act, 1949.

[61] This ceiling is not applicable where the investment is funded out of balances held by the Indian party in its Exchange Earners' Foreign Currency (EEFC) account.

[62] RBI/2007-2008/274 A. P. (DIR Series) Circular No. 34 dated April 3, 2008

iv) foreign debt securities in countries with fully convertible currencies, short term as well as long term debt instruments with rating not below investment grade by accredited / registered credit rating agencies;

v) money market instruments rated not below investment grade;

vi) repos in the form of investment, where the counterparty is rated not below investment grade. The repos should not, however, involve any borrowing of funds by mutual funds;

vii) government securities where the countries are rated not below investment grade;

viii) derivatives traded on recognized stock exchanges overseas only for hedging and portfolio balancing;

ix) short term deposits with banks overseas where the issuer is rated not below investment grade;

x) units / securities issued by overseas mutual funds or unit trusts registered with overseas regulators and investing in (a) aforesaid securities, (b) Real Estate Investment Trusts (REITs) listed on recognized stock exchanges overseas, or (c) unlisted overseas securities (not exceeding 10 per cent of their net assets).

Swap or Exchange of Shares**.** An Indian company can invest in a foreign company which is engaged in a *bona fide* business activity in exchange of ADRs/GDRs issued to the foreign company in accordance with the ADR/GDR Scheme mentioned above. In order to be eligible for investment under this route, the Indian company must already have made an ADR/GDR issue, and such ADRs/GDRs must be listed on a stock exchange outside India. The ADR/GDR issue must be backed by a fresh issue of underlying equity shares by the Indian company, and the underlying shares must be valued by an investment banker, or as per the valuation procedure prescribed in the regulations. If the investment is made by way of remittance from India in an existing company outside India, the valuation of shares shall be done by a Category I Merchant Banker registered with the SEBI where the investment is more than USD 5 million and by a certified Chartered Accountant or Certified Public Accountant where the investment is less than USD 5 million.

Investment by way of capitalization of exports, or fees royalties etc., due to the Indian company. The ODI Regulations permit a company to invest in an entity outside India by way of capitalization of amounts due to it from the investee company, for sale of plant, machinery, equipment and other goods/software, or any fees, royalty, commissions or other entitlements due to it for transfer of technical know-how, consultancy, managerial or other services. A special case is carved out for a software exporter who wishes to start a software company overseas – the Indian exporter is permitted to receive shares upto 25% of the value of exports in the start-up company by filing an application with the authorized dealer.

Additional investments in existing JV/WOS. Under the ODI Regulations, an Indian company is permitted to make additional investments, or alter the shareholding of an existing JV/WOS subject to compliance with the reporting requirements.

Transfer of shares. An Indian company may transfer by way of sale to another Indian company, the securities of an overseas JV/WOS which has been in operation for a year provided that the following conditions are fulfilled:

- The sale should not result in any write off of the investment made;
- The sale should be through the stock exchange on which the securities of the overseas JV/WOS are listed. Where the shares of the JV/WOS company are not listed, the sale price of the shares should not be less than the fair value of the shares as determined by a certified Chartered Accountant or Certified Public Accountant;
- The exiting Indian seller does not have any dues from the JV/WOS.

The securities of the JV/WOS may also be pledged by the Indian company as security, to avail of fund/non-fund based credit facilities for itself or for the JV/WOS.

2. Investment by Individuals

Under the ODI Regulations, there are limits on individuals owning shares in foreign companies. An individual may *inter-alia* invest in equity and in rated bonds / fixed income securities of overseas companies as permitted in terms of the limits and conditions specified under the Liberalized Remittance Scheme (upto a maximum amount of USD 200,000). The Liberalized Remittance Scheme was introduced in 2004 to simplify and liberalize the foreign exchange facilities available to resident individuals. Remittance under the Scheme is permitted for any permitted current or capital account transactions or a combination of both. The funds remitted can be used for various purposes such as purchasing objects, making gifts and donations, acquisition of employee stock options and units of Mutual Funds, Venture Funds, unrated debt securities, promissory notes, etc., under this Scheme.

Further, general permission has been granted to individuals to acquire foreign securities:

- as a gift from any person resident outside India,
- under Cashless Employees Stock Option Scheme issued by a company outside India, provided it does not involve any remittance from India,
- by way of inheritance from a person whether resident in or outside India,
- under ESOP Schemes, if he is an employee, or, a director of an Indian office or branch of a foreign company, or, of a subsidiary in India of a foreign company, or, an Indian company in which foreign equity holding, either direct or through a holding company/Special Purpose Vehicle (SPV), is not less than 51 per cent,
- if they represent qualification shares for becoming a director of a company outside India not exceeding 1 % of the paid up capital of the overseas company , provided the consideration for the acquisition does not exceed USD 20,000 in a calendar year, and
- if they are rights shares.

Any person intending to make any investments other than those specifically covered under the ODI Regulations must obtain the prior approval of the RBI.

VI. Taxes and Duties

A. **<u>INCOME TAX ACT, 1961</u>**.

The ITA contemplates and recognizes the following types of mergers and acquisitions activities:

- Amalgamation (i.e. a merger which satisfies the conditions mentioned below[63])
- Slump sale/asset sale;
- Transfer of shares; and
- Demerger or spin-off.

The ITA defines an 'amalgamation' as the merger of one or more companies with another company, or the merger of two or more companies to form one company. The ITA also requires that the following conditions must be met by virtue of the merger, for such merger to qualify as an 'amalgamation' under the ITA:

- all the property of the amalgamating company(ies) becomes the property of the amalgamated company;
- all the liabilities of the amalgamating company(ies) become the liabilities of the amalgamated company; and
- shareholders holding not less than 75% of the value of the shares of the amalgamating company become shareholders of the amalgamated company.

1. **Tax on Capital Gains**.

Section 45 of the ITA levies tax on capital gains arising on the transfer of a capital asset[64]. Section 2(47) of the ITA defines the term 'transfer' in relation to a capital asset to include:

(i) The sale, exchange or relinquishment of the asset; or
(ii) The extinguishment of any rights therein; or
(iii) The compulsory acquisition thereof under any law; or
(iv) In a case where the asset is converted by the owner thereof into, or is treated by him as, stock–in–trade of a business carried on by him, such conversion or treatment; or
(v) Any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882; or
(vi) Any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever), which has the effect of transferring, or enabling the enjoyment of, any immovable property.

If a merger or any other kind of restructuring results in a transfer of a capital asset (as defined above), it would lead to a taxable event.

<u>Capital gains tax implications for mergers</u>. Section 47 of the ITA sets out certain transfers that are exempt from the provisions of Section 45 (the charging provision for tax on capital gains) and such transfers are exempt from tax on capital gains. The relevant exemptions are provided below.

- *for an amalgamating company (transferor)*

[63] Section 2(1B)

[64] Section 2 (14) defines 'capital asset' as property of any kind held by an assessee whether or not connected with his business or profession, but excludes (a) stock in trade, consumable stores or raw materials held for the purposes of his business or profession, (b) personal effects, i.e. movable property held for personal use, and (c) certain agricultural land.

Section 47(vi): The transfer of a capital asset in a scheme of amalgamation by the amalgamating company to the amalgamated company is exempt from tax on capital gains, provided the amalgamated company is an Indian company[65]. Please note that for this exemption to be applicable to a merger, it is essential that the merger falls within the definition of 'amalgamation' provided above.

- *for a foreign amalgamating company (transferor) in connection with transfer of shares in an Indian company*

Section 47(via): When a foreign holding company transfers its shareholding in an Indian company to another foreign company as a result of a scheme of amalgamation, such a transfer of the capital asset *i.e*. shares in the Indian company, would be exempt from tax on capital gains in India for the foreign amalgamating company, if it satisfies the following conditions: (a) At least 25% of the shareholders of the amalgamating foreign company continue to be the shareholders of the amalgamated foreign company, and (b) such transfer does not attract capital gains tax in the country where the amalgamating company is incorporated. It may be noted that while the definition of 'amalgamation' under Section 2(1B) requires that 75% (in terms of value of shares) of the shareholders of the amalgamating company should become the shareholders in the amalgamated company, this section specifies 25% of the number of shareholders as the corresponding figure. The above provisions also indicate that an Indian company may not amalgamate into a foreign company without attracting capital gains tax liability in India, as and when permitted by the Companies Act.

- *shareholders of the amalgamating company*

Section 47(vii): Transfer by the shareholders of amalgamating company, in a scheme of amalgamation, of shares of the amalgamating company (the capital asset) as consideration for the allotment of shares of the amalgamated company, is exempt from tax on capital gains, provided that the amalgamated company is an Indian company[66]. The exemption from tax on capital gains would only be to the extent that the transfer is for the consideration for shares of the amalgamated company. If any cash consideration was paid to the shareholders of the amalgamating company, it would be liable to tax on capital gains. If any of the conditions specified above are not satisfied (including the conditions specified in the definition of 'amalgamation'), the transfer of capital assets in a merger would be subject to tax on capital gains.

Computation of capital gains tax. Income chargeable to tax as capital gains is computed by deducting the following from the value of the consideration received – (a) expenditure incurred wholly and exclusively with such transfer, and (b) cost of acquisition of the capital asset and any cost of improvement of the capital asset. Section 49 (2) provides that the cost of acquisition for a shareholder, of shares of the amalgamated company, is deemed to be the cost of acquisition of the shares of the amalgamating company.

For example, a shareholder X acquires shares in a company ('**A-Co'**) for INR 100. A-Co subsequently merges into another company ('**B-Co'**) and X receives shares in B-Co. The cost of acquisition of the shares of B-Co for X

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[65] This section only requires that the amalgamated (or the surviving) company must be an Indian company. The amalgamating company may be an Indian company or a foreign company. In this connection it is useful to note that the meaning of the term 'company' under the Companies Act differs considerably from the meaning under the ITA. Under the Companies Act, 'company' would generally refer to an Indian company (unless specifically provided otherwise). Under the ITA, the term 'company' has a much broader meaning and inter alia includes an Indian company and a foreign body corporate (i.e. including a foreign company).

[66] In this scenario, the shareholders get shares of the amalgamated company in exchange for their shareholding in the amalgamating company, and the amalgamating company is dissolved. It should be noted that the term transfer is used here in the context of the definition of this term under the ITA, which includes the extinguishment of any right in a capital asset. So if the rights of the shareholders in the shares of the amalgamating company are extinguished, it would amount to a transfer (which is exempt from capital gains tax if the conditions specified are complied with).

would be INR 100, and if X subsequently sold his shareholding in B-Co, the capital gains, if any, would be computed using INR 100 as the cost of acquisition of the shares of B-Co.

Long term and short term capital gains. If a capital asset is held by an assessee for not more that 3 years immediately prior to the transfer, such capital asset would be a short term capital asset. If the capital asset is held for more than 3 years, then it is a long term capital asset. Any other capital asset would be a short term capital asset. However, in case of shares of a company/ security listed on a stock exchange, it would be a short term capital asset if it is held by the assessee for a period not exceeding 1 year. This distinction is important as the rate of capital gains tax on transfer of short term capital assets and long term capital assets differs. In the example mentioned in the paragraph above, if X sold the shares of B-Co, the period of holding of such shares for X would commence on the date X acquired shares in A-Co, and not the date of allotment of shares in B-Co.

Long-term capital gains realized on the transfer of listed shares of Indian companies on the floor of a recognized stock exchange in India are exempt from taxation in India, provided such transaction is subject to securities transaction tax ("**STT**") as further discussed below. Long-term capital gains arising on transfer of listed shares of Indian companies off the recognized stock exchange in India will be chargeable to tax at a rate of 10.558% (including surcharge and education cess but without indexation benefits). Long-term capital gains with respect to shares of an unlisted company are subject to Indian tax at a rate of 21.012% (including surcharge and education cess but with indexation benefits).

Short-term capital gains realized on the transfer of listed shares of Indian companies on the floor of a recognized stock exchange in India are subject to tax at a rate of 15.759% (including surcharge and education cess), provided such transaction is subject to STT. Short-term capital gains on the transfer of an Indian security that is listed but not subject to STT, or is unlisted are subject to tax at a rate of 42.024% (including surcharge and education cess).

All transactions entered into on a recognized stock exchange in India will be subject to STT, which is levied on the transaction value. In the case of sale of equity shares on a delivery basis, STT is generally levied at the rate of 0.125% on the value of the transaction on both the buyer and seller of the equity shares.

<u>Capital gains tax implications for demergers</u>. The term 'demerger' in relation to companies is defined by Section 2(19AA) of the ITA to mean the transfer, pursuant to a scheme of arrangement under the Merger Provisions by a demerged company of its one or more undertakings, to any resulting company, in such a manner that:

- All the *property* of the undertaking[67], being transferred by the demerged company, immediately before the demerger becomes the property of the resulting company by virtue of the demerger;
- All the *liabilities*[68] relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
- The property & the liabilities of the undertaking/undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

[67] The term 'undertaking' would include any part of an undertaking, any unit or division of an undertaking or a business activity as whole, but does not include individual assets or liabilities which do not constitute a business activity.

[68] The term 'liabilities' would include liabilities and specific loans/borrowings incurred or raised for the specific business activity of the undertaking. In case of a multipurpose loan, such value of the loan will be included, that bears the same proportion as the value of the demerged assets to the total assets of the company.

- The *resulting company issues*, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;

- The *shareholders holding not less than 3/4ths in value* of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or its subsidiary) become shareholders of the resulting company(ies) by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

- The transfer of the undertaking is on a going concern basis;

- The demerger is in accordance with the conditions, if any, notified under subsection (5) of section 72A by the Central Government in this behalf.

Section 2(19AAA) of the ITA defines the term “demerged company” to mean a company, whose undertaking is transferred, pursuant to a demerger, to a resulting company. Section 2(41A) defines a “resulting company” to mean one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company.

The ITA contains certain tax beneficial provisions in the case of a demerger. If the demerger fulfills the conditions listed above, the transfer of assets by the demerged company to a resulting company, which must be an Indian company, is exempted from capital gains tax under Section 47(vib) of the ITA.

Further, when a demerger of a foreign company occurs, whereby both the demerged and resulting companies are foreign, but the assets demerged include or consist of shares in an Indian company, the transfer of these shares is exempt from capital gains tax in the hands of the demerged company under Section 47(vic) of the IT Act, if the following conditions are satisfied:

- The shareholders holding at least three fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

- Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

Since such a demerger would not occur in India and hence the provisions of the Companies Act would not be applicable, the requirement of the application of the Merger Provisions to such a demerger, is not required to be satisfied.

<u>Capital gains tax implications for a slump sale</u>. A slump sale is a transaction in which restructuring takes place as a result of which the transferor transfers one or more of its undertakings on a going concern basis for a lump sum consideration, without assigning values to the individual assets and liabilities of the undertaking[69]. If the undertaking, which is being sold under slump sale was held by the transferor for more than 36 months, the capital gains realized on such sale would be taxed as long term capital gains, i.e. at the rate of 21.63%. If however, the undertaking were to be held for 36 months or less, the capital gains realized would be taxed as short term capital gains, i.e. at the rate of 32.45%. For the purpose of computing capital gains, the cost of acquisition would be the ‘net worth’ of the undertaking on the date of the transfer[70].

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[69] Section 2(42C) of the ITA

[70] Section 50B of the ITA

A slump sale is useful in situations when it would not be feasible to go through the process of amalgamation or demerger under the Merger Provisions. It is also a preferred route if there is a cash consideration rather than issuance of shares for the transfer of business. This method is not particularly favored for its tax implications (*vis-a-vis* a merger).

Capital gains tax implications for an asset sale (itemized sale). In an asset sale, the acquirer only purchases the assets of the seller. This does not amount to the transfer of the business as a going concern and specific values are attributed to each of the assets. The capital gains tax payable by the seller will depend on the period that the seller has held each of the assets that are transferred. This method of acquisition is usually used where the acquirer does not want to acquire the liabilities of the seller, and more so if the acquirer believes that the seller has not disclosed certain liabilities or there is a distinct possibility that unforeseen liabilities could arise in the future.

Tax rates for capital gains on transfer of shares. The rates of tax on capital gains differ depending on whether the capital asset is a short term capital asset or a long term capital asset, whether the transferor is resident / non-resident etc. As discussed earlier, the rates of tax on capital gains arising out of a transfer of shares would be applicable to all mergers and acquisitions that involve non-exempt transfers of shares.

2. **Tax on business income - Carry forward of losses**.

Section 72A of the ITA provides that in case of amalgamation of a company owning an industrial undertaking[71] with another company, the accumulated loss and the unabsorbed depreciation of the amalgamating company is deemed to be the loss / allowance for depreciation, of the amalgamated company. The amalgamated company would then be entitled to carry forward such loss and depreciation, and set off such amounts against its future profits. However for this entitlement, the following conditions must be satisfied:
The amalgamated company:

- Holds 3/4ths of the book value of the fixed assets which it acquired from the amalgamating company continuously for a period of five (5) years from the date of amalgamation;

- Continues to carry on the business of the amalgamating company for a minimum period of five (5) years from the date of amalgamation. This would imply that if the amalgamating company were engaged in more than one business prior to amalgamation, the amalgamated company would be required to carry on all of those businesses; and

- Fulfills such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

Further, the amalgamating company:

- has been engaged in the business, in which the loss occurred or depreciation remained unabsorbed, for 3 or more years; and

- has held continuously, on the date of amalgamation, at least 3/4ths of the book value of the fixed assets held by it 2 years prior to the date of amalgamation.

[71] Industrial undertaking means an undertaking engaged in manufacture or processing of good, manufacture of computer software, generation/distribution of electricity/power, telecommunications services etc. This does not cover undertakings in the software service sector and certain other service sectors.

Section 72A(4) of the ITA provides a similar benefit for demergers. However, in the case of a demerger, the company does not need to satisfy any conditions similar to those applicable to mergers. In the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall:

- where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;

- where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

B. **SERVICE TAX.**

In an asset purchase or a slump sale, where the object is to acquire the business of the seller, there may be a covenant in the asset purchase agreement that the seller will procure that its employees accept offers of employment with the acquirer. Part of the consideration payable to the seller may be contingent on the number of employees who join the acquirer. It is possible that such a covenant could amount to the provision of manpower recruitment services by the seller on which service tax at the rate of 10.30% (including education cess) may be payable.

C. **VALUE ADDED TAX/SALES TAX**.

Value added tax ('**VAT**') or sales tax, as the case may be, may be payable on a purchase of movable assets or goods of the target by the acquirer. Most Indian states have in the last few years replaced their state sales tax laws with laws levying VAT on the sale of goods. We have analyzed some of the relevant provisions of the Karnataka Value Added Tax Act, 2003 ("**KVAT**"), in connection with the sale of goods in an asset purchase.

Under the KVAT, VAT is payable on a 'sale' of goods[72]. The term 'sale' is defined to inter alia include a transfer of property in goods by one person to another *in the course of trade or business* for cash, deferred payment or other valuable consideration etc. Therefore, the sale must be in the course of trade or business in order to attract VAT. Since the seller would usually not be in the business of buying or selling the assets proposed to be acquired, and the sale of a business does not amount to a sale of goods, it could be said that a transfer of goods in connection with the sale of the business of the seller, is not a sale attracting VAT under the KVAT. However this argument may be applied only in the case of a slump sale where the business is transferred as whole and not in the case of an itemized sale of assets.

The law pertaining to VAT is state specific and the argument stated above regarding non-applicability of the VAT law to an asset sale, may not be applicable in other Indian States. For example, the Maharashtra Value Added Tax Act, 2002 defines the term 'business' to include any transaction in connection with the commencement or closure of business. Therefore, a slump sale of a business could be a sale in the ordinary course of business and could attract VAT. However an argument can be raised that a slump sale transaction would not attract VAT.

[72] The term 'goods' generally includes all kinds of movable property (other than actionable claims, stocks, shares and securities)

D. **STAMP DUTY**.

Stamp duty is a duty payable on certain specified instruments / documents. Broadly speaking, when there is a conveyance or transfer of any movable or immovable property, the instrument or document effecting the transfer is liable to payment of stamp duty.

Stamp duty on court order for mergers/demergers. Since the order of the Court merging two or more companies, or approving a demerger, has the effect of transferring property to the surviving /resulting company, the order of the Court may be required to be stamped. The stamp laws of most states require the stamping of such orders. The amount of the stamp duty payable would depend on the state specific stamp law.

Stamp duty on share transfers. The stamp duty payable on a share transfer form executed in connection with a transfer of shares is 0.25% of the value of, or the consideration paid for, the shares. However, if the shares are in dematerialised form, the abovementioned stamp duty is not applicable.

Stamp duty on shareholder agreements/joint venture agreements. Stamp duty will be payable as per the state specific stamp law.

Stamp duty on share purchase agreements. Stamp duty may be payable on an agreement that records the purchase of shares/debentures of a company. This stamp duty is payable in addition to the stamp duty on the share transfer form.

Transaction costs for asset purchase vs. share purchase. Transaction related costs, are generally higher in the case of an asset purchase as compared to a share purchase. This is primarily because in a share purchase, there would usually be no incidence of sales tax/value added tax/service tax, which may be levied on different aspects of an asset purchase.

Further, the rate stamp duty is also usually higher in an asset purchase, and as discussed above is dependent on the nature of the assets transferred. The stamp duty on a transfer of shares is 0.25% of the consideration payable for the shares, which rate is far less than the stamp duty rates applicable for transfer of movable/immovable assets.

However it should be kept in mind that while a share purchase will involve lower transaction costs, the degree of risk with such an acquisition is typically higher, as the acquirer inherits all the liabilities and obligations of the target company.

Special Economic Zones. A Special Economic Zone ("**SEZ**") is a specified, delineated and duty-free geographical region that has different economic laws from those of the country in which it is situated. To provide a stable economic environment for the promotion of export-import of goods in a quick, efficient and trouble-free manner, the Government of India enacted the Special Economic Zones Act, 2005. Developers of SEZs and units set up in SEZs enjoy several fiscal benefits, such as exemption from income tax for specified periods, customs and excise duty exemptions, etc. A unit in the SEZ must however be net foreign exchange positive within a certain period.

If a target company is a unit in an SEZ, or registered as any kind of export oriented unit ("**EOU**"), then its assets may be bonded by the customs authorities, and in such a case, they must be debonded prior to the transfer. Debonding of assets usually involves payment of customs, excise and any other duties, that the target did not pay at the time of acquisition of the assets on account of the benefits / exemptions available under the SEZ/EOU schemes. However, if the acquirer is also an SEZ or EOU unit, then it may be possible to transfer the assets 'in-bond', i.e. between the two units without debonding the assets. In such a case customs and excise duty is not payable.

VII. Conclusion

As Dale Carnegie[73] said "Flaming enthusiasm, backed by horse sense and persistence, is the quality that most frequently makes for success". A quote that holds good for M&A in India, and a credo to which Indian companies seem to subscribe given their successes to date in completing acquisitions. There is little to stop Indian companies that desire to be global names for playing the merger and amalgamation game globally. With a plethora of financing options, this aspiration has become a reality for many corporate houses, who can now boast of having the best in the industry under their wings. Indian companies have often surpassed their foreign counterparts in corporate restructuring both within and beyond the national frontiers.

Mergers and acquisitions are powerful indicators of a robust and growing economy. The legal framework for such corporate restructuring must be easy and facilitative and not restrictive and mired in bureaucratic and regulatory hurdles. The biggest obstacle in the way of completing a merger or an amalgamation remains the often long drawn out court procedure required for the sanction of a scheme of arrangement. The recommendations of the JJ Irani Report are of particular significance in this regard. The Report has recommended that legal recognition to 'contractual merger' (i.e., mergers without the intervention of the court) can go a long way in eliminating the obstructions to mergers in India. The report also recommended that the right to object to a scheme of merger/ acquisition should only be available to persons holding a substantial stake in the company.

As George Bernard Shaw[74] is reputed to have said "*we are made wise not by the recollection of our past, but by the responsibility for our future*", and the future of India is bright indeed.

\- **Team M&A**

Authors:

Nishchal Joshipura (nishchal@nishithdesai.com)
Sangeeta Rana (sangeeta@nishithdesai.com)
Arun Scaria (aruns@nishithdesai.com)

[73] November 24, 1888 – November 1, 1955.

[74] July 26, 1856 – November 2, 1950, Nobel Prize for Literature 1925.

Annexure 1 - Merger Provisions

390. Interpretation of sections 391 and 393.

In sections 391 and 393,-

(a) the expression "company" means any company liable to be wound up under this Act;
(b) the Expression "arrangement" includes a reorganisation of the share capital of the company by the consolidation of shares of different classes, or by the division of shares into shares of different classes or, by both those methods; and
(c) unsecured creditors who may have filed suits or obtained decrees shall be deemed to be of the same class as other unsecured creditors.

391. Power to compromise or make arrangements with creditors and members

(1) Where a compromise or arrangement is proposed-

(a) between a company and its creditors or any class of them; or

(b) between a company and its members or any class of them,

the Tribunal may, on the application of the company or of any creditor or member of the company or, in the case of a company which is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be to be called, held and conducted in such manner as the Tribunal directs.

(2) If a majority in number representing three-fourths in value of the creditors, or class of creditors, or members, or class of members as the case may be, present and voting either in person or, where proxies are allowed under the rules made under section 643, by proxy, at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Tribunal, be binding on all the creditors, all the creditors of the class, all the members, or all the members of the class, as the case may be, and also on the company, or, in the case of a company which is being wound up, on the liquidator and contributories of the company:

Provided that no order sanctioning any compromise or arrangement shall be made by the Tribunal unless the Tribunal is satisfied that the company or any other person by whom an application has been made under sub-section (1) has disclosed to the Tribunal, by affidavit or otherwise, all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company, the pendency of any investigation proceedings in relation to the company under sections 235 to 351, and the like.

(3) An order made by the Tribunal under sub-section (2) shall have no effect until a certified copy of the order has been filed with the Registrar.

(4) A copy of every such order shall be annexed to every copy of the memorandum of the company issued after the certified copy of the order has been filed as aforesaid, or in the case of a company not having a memorandum, to every copy so issued of the instrument constituting or defining the constitution of the company.

(5) If default is made in complying with sub-section (4), the company, and every officer of the company who is in default, shall be punishable with fine which may extend to one hundred rupees for each copy in respect of which default is made.

(6) The Tribunal may, at any time after an application has been made to it under this section stay the commencement or continuation of any suit or proceeding against the company on such terms as the Tribunal thinks fit, until the application is finally disposed of.

392. Power of Tribunal to enforce compromise and arrangement.

(1) Where the Tribunal makes an order under section 391 sanctioning a compromise or an arrangement in respect of a company, it-

(a) shall have power to supervise the carrying out of the compromise or an arrangement; and

(b) may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement.

(2) If the Tribunal aforesaid is satisfied that a compromise or an arrangement sanctioned under section 391 cannot be worked satisfactorily with or without modifications, it may, either on its own motion or on the application of any person interested in the affairs of the company, make an order winding up the company, and such an order shall be deemed to be an order made under section 433 of this Act.

(3) The provisions of this section shall, so far as may be, also apply to a company in respect of which an order has been made before the commencement of the Companies (Amendment) Act, 2001 sanctioning a compromise or an arrangement.

393. Information as to compromises or arrangements with creditors and members

(1) Where a meeting of creditors or any class of creditors, or of members or any class of members, is called under section 391,-

(a) with every notice calling the meeting which is sent to a creditor or member, there shall be sent also a statement setting forth the terms of the compromise or arrangement and explaining its effect; and in particular, stating any material interests of the directors, managing director or manager of the company, whether in their capacity as such or as members or creditors of the company or otherwise, and the effect on those interests of the compromise or arrangement if, and in so far as, it is different from the effect on the like interests of other persons; and

(b) in every notice calling the meeting which is given by advertisement, there shall be included either such a statement as aforesaid or a notification of the place at which and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement as aforesaid.

(2) Where the compromise or arrangement affects the rights of debenture-holders of the company, the said statement shall give the like information and explanation as respects the trustees of any deed for securing the issue of the debentures as it is required to give as respects the company's directors.

(3) Where a notice given by advertisement includes a notification that copies of a statement setting forth the terms of the compromise or arrangement proposed and explaining its effect can be obtained by creditors or members entitled to attend the meeting, every creditor or member so entitled shall, on making an application in the manner indicated by the notice, be furnished by the company, free of charge, with a copy of the statement.

(4) Where default is made in complying with any of the requirements of this section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to fifty thousand rupees];

and for the purpose of this sub-section any liquidator of the company and any trustee of a deed for securing the issue of debentures of the company shall be deemed to be an officer of the company:

Provided that a person shall not be punishable under this sub-section if he shows that the default was due to the refusal of any other person, being a director, managing director, manager or trustee for debenture holders, to supply the necessary particulars as to his material interests.

(5) Every director, managing director, or manager of the company, and every trustee for debenture holders of the company, shall give notice to the company of such matters relating to himself as may be necessary for the purposes of this section; and if he fails to do so, he shall be punishable with fine which may extend to five thousand rupees.

394. Provisions for facilitating reconstruction and amalgamation of companies

(1) Where an application is made to the Tribunal under section 391 for the sanctioning of a compromise or arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the Tribunal-

(a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of any company or companies, or the amalgamation of any two or more companies; and

(b) that under the scheme the whole or any part of the undertaking, property or liabilities of any company concerned in the scheme (in this section referred to as a "transferor company") is to be transferred to another company (in this section referred to as "the transferee company");

the Tribunal may, either by the order sanctioning the compromise or arrangement or by a subsequent order, make provision for all or any of the following matters:-

(i) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company;

(ii) the allotment or appropriation by the transferee company of any shares, debentures policies, or other like interests in that company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person;

(iii) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company;

(iv) the dissolution, without winding up, of any transferor company;

(v) the provision to be made for any persons who, within such time and in such manner as the Court directs dissent from the compromise or arrangement; and

(vi) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out:

Provided that no compromise or arrangement proposed for the purposes of, or in connection with, a scheme for the amalgamation of a company, which is being wound up, with any other company or companies; shall be sanctioned by the Tribunal unless the Court has received a report from the Registrar that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest:

Provided further that no order for the dissolution of any transferor company under clause (iv) shall be made by the Tribunal unless the Official Liquidator has, on scrutiny of the books and papers of the company, made a report to the Tribunal that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest.

(2) Where an order under this section provides for the transfer of any property or liabilities, then, by virtue of the order; that property shall be transferred to and vest in and those liabilities shall be transferred to and become the liabilities of the transferee company and in the case of any property, if the order so directs, freed from any charge which is, by virtue of the compromise or arrangement, to cease to have effect.

(3) Within thirty days after the making of an order under this section, every company in relation to which the order is made shall cause a certified copy thereof to be filed with the Registrar for registration.

If default is made in complying with this sub-section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five hundred rupees.

(4) In this section-

(a) "property" includes property rights and powers of every description; and "liabilities" includes duties of every description; and

(b) "Transferee company" does not include any company other than a company within the meaning of this Act; but "transferor company" includes any body corporate, whether a company within the meaning of this Act or not.

Annexure 2 – Meaning of 'Persons Acting in Concert'

Regulation 2(1) (q) "person acting in concert" means, -

persons who, with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly co-operate for acquisition of shares or voting rights in, or exercise of control over the target company.

Without prejudice to the generality of the foregoing, the persons falling within the following categories shall be deemed to be persons acting in concert with other persons within the same category, unless the contrary is established,—

(i) a company, its holding company, subsidiary company and any company under the same management or control;

(ii) a company, its directors, and any person entrusted with the management of the company;

(iii) directors of companies referred to in item (i) and (ii) of this sub-clause and associates of such directors;

(iv) promoters and members of the promoter group;

(v) immediate relatives;

(vi) a mutual fund, its sponsor, trustees, trustee company, and asset management company;

(vii) a collective investment scheme and its collective investment management company, trustees and trustee

company;

(viii) a venture capital fund and its sponsor, trustees, trustee company and asset management company;

(ix) a foreign institutional investor and its sub-accounts;

(x) a merchant banker and its client, who is an acquirer;

(xi) a portfolio manager and its client, who is an acquirer;

(xii) banks, financial advisors and stock brokers of the acquirer, or of any company which is a holding company or subsidiary of the acquirer, and where the acquirer is an individual, of the immediate relative of such individual:

Provided that this sub-clause shall not apply to a bank whose sole role is that of providing normal commercial banking services or activities in relation to an open offer under these regulations;

(xiii) an investment company or fund and any person who has an interest in such investment company or fund as a shareholder or unit holder having not less than 10 per cent of the paid-up capital of the investment company or unit capital of the fund, and any other investment company or fund in which such person or his associate holds not less than 10 per cent of the paid-up capital of that investment company or unit capital of that fund:

Note: For the purposes of this clause `associate' means:

a. any immediate relative of such person;
b. trusts of which such person or his immediate relative is a trustee;
c. partnership firm in which such person or his immediate relative is a partner; and
d. members of Hindu undivided families of which such person is a coparcener.

Qualifying Persons under the Takeover Code include:

a. immediate relatives;
b. persons named as promoters in the shareholding pattern filed by the target company in terms of the listing agreement or these regulations for not less than three years prior to the proposed acquisition;
c. a company, its subsidiaries, its holding company, other subsidiaries of such holding company, persons holding not less than fifty per cent of the equity shares of such company, other companies in which such persons hold not less than fifty per cent of the equity shares, and their subsidiaries subject to control over such qualifying persons being exclusively held by the same persons;
d. persons acting in concert for not less than three years prior to the proposed acquisition, and disclosed as such pursuant to filings under the listing agreement; and
e. shareholders of a target company who have been persons acting in concert for a period of not less than three years prior to the proposed acquisition and are disclosed as such pursuant to filings under the listing agreement, and any company in which the entire equity share capital is owned by such shareholders in the same proportion as their holdings in the target company without any differential entitlement to exercise voting rights in such company.

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Annexure 3 – FAQs on Competition Law

Prelude

Competition, in a market, has been defined to mean a situation in which *firms or sellers independently strive for the buyers' patronage in order to achieve a particular business objective for example, profit, sales or market share*[75]. The economic analysis of competition shows that the ideal scenario of perfect competition can maximize the benefit to the consumers as demand equals supply and hence the consumers get the best goods / services at the market price. The fundamental reason that competition is favored over a situation of monopoly is that competition drives markets to a more efficient use of scarce resources.

The premise on which Indian competition laws have been drafted is to protect the interest of consumers. Competition law protects competitive markets and prohibits certain types of anti competitive conduct. It can be argued that consumers need no special protection, and that their behavior can be governed by the market forces. However, a perfectly competitive market is a utopian concept and consumer sovereignty is a much-denounced myth.

In pursuit of globalization, India has responded well by opening up its economy, removing controls and resorting to liberalization. The globalized and liberalized industry is facing cut - throat competition. As a natural corollary to this, India has enacted the new competition law called the Competition Act, 2002 ("**Competition Act**") which has replaced the Monopolies and Restrictive Trade Practices Act, 1969 ("**MRTP Act**") and provides institutional support to healthy and fair competition.

Since the substantive provisions of the Competition Act relating to anti competitive agreements (Section 3) and abuse of dominance (Section 4) have been notified and the provisions relating to combinations (Section 5 and 6) is expected to be notified soon, it is worthwhile to have a quick glance at the mechanics of the Competition Act. Further, Section 66 of the Competition Act which expressly repeals the MRTP Act has also been notified on August 28, 2009 with effect from September 1, 2009. The Competition Act is a shift from curbing monopolies to encouraging competition and is designed to repeal the extant MRTP Act.

Outline of the paper

This paper provides an elementary guide for both foreign and domestic deal makers with respect to competition law in India. The paper is divided into four parts:

- **Part I:** Introduction
- **Part II:** Anti competitive agreements
- **Part III**: Abuse of dominance
- **Part IV**: Combinations

Chronology of Key Events

Date	Key Event
June 01, 1970	The Monopolies & Restrictive Trade Practices Act, 1969, ("**MRTP Act**") the first enactment to deal with competition law, came into effect
October 1999	The Government appointed a committee to examine the existing MRTP Act for shifting the focus of the law from curbing monopolies to promoting competition

[75] World Bank, *A Framework for the Design and Implementation of Competition Law and Policy,* 1999.

	in line with the international environment
January 13, 2003	Pursuant to the recommendations of the committee as aforesaid, the Competition Act, 2002 was enacted
March 09, 2006	The Competition (Amendment) Bill, 2006 was introduced to amend the Competition Act, 2002
August 29, 2007	The Competition (Amendment) Bill, 2006 was withdrawn and replaced by the Competition Amendment Act, 2007
January 19, 2008	Draft of Competition Commission (Combinations) Regulations introduced
May 15, 2009	Notification of Section 3 (Anti-competitive agreements) and Section 4 (Abuse of Dominance)
May 20, 2009	Section 3 (Anti-competitive agreements) and Section 4 (Abuse of Dominance) brought into effect
August 13, 2009	Competition Commission of India (Lesser Penalty) Regulations, 2009 promulgated
August 28, 2009	Notification of Section 66 (Repeal of the MRTP Act)
September 1, 2009	Repeal of the MRTP Act brought into effect
March 04, 2011	Notification of Section 5 (Combinations), Section 6 (Regulation of Combinations), Section 20 (Inquiry into Combinations by Commission), Section 29 (Procedure for Investigation of Combinations), Section 30 [Procedure in case of Notice under Sub-Section (2) of Section 6] and Section 31 (Orders of Commission on certain Combinations).
June 01, 2011	Section 5 (Combinations), Section 6 (Regulation of Combinations), Section 20 (Inquiry into Combinations by Commission), Section 29 (Procedure for Investigation of Combinations), Section 30 [Procedure in case of Notice under Sub-Section (2) of Section 6] and Section 31 (Orders of Commission on certain Combinations) brought into effect.

<u>Part I: Introduction</u>

Q. WHEN WAS COMPETITION LAW ENACTED IN INDIA?

A. In India, MRTP Act was the first enactment that came into effect on June 1, 1970, to deal with competition issues. It underwent a number of amendments, most notably in 1984 and 1991.

Thereafter, Government of India appointed a committee in October, 1999 to examine the existing MRTP Act for shifting the focus of the law from curbing monopolies to promoting competition and to suggest a modern competition law. Pursuant to the recommendations of the committee, the Competition Act was enacted. The jurisprudence of the MRTP regime while interpreting the substantive provisions of MRTP Act may be of persuasive value while interpreting the substantive provisions of the Competition Act.

Further, Competition Act was amended vide the Competition (Amendment) Act, 2007 ("**Amendment Act**") which received presidential assent towards the end of 2007 and brought significant changes to the Competition Law regime in India. Most noteworthy of the changes proposed by the Amendment Act was the introduction of a mandatory notification process for persons undertaking combinations above prescribed threshold limits. The Amendment Act also introduced a lengthy waiting period of 210 days within which the Competition Commission of India ("**CCI**") is required to pass its order with respect to the notice received, failing which, the proposed combination is deemed to be approved.

Q. WHETHER PROVISIONS OF MRTP ACT ARE PRESENTLY STILL IN FORCE?

A. Vide a notification dated August 28, 2009, Section 66 of the Competition Act has been brought into force by virtue of which the MRTP Act shall be repealed with effect from September 1, 2009. Until the notification of this section, there was some uncertainty over which law would regulate anti competitive practices given that certain overlapping provisions of the MRTP Act as also the Competition Act were both in force at the same time. The notification of Section 66 resolves this issue by providing that the MRTP Act will now stand repealed and the two year period for dissolution of the MRTP Commission begins on September 1, 2009.

Therefore, as regards pending cases (i.e., cases or proceedings filed before the commencement of the Competition Act), a two year time frame has been provided during which the MRTP Commission may continue to exercise its jurisdiction and power under the MRTP Act (for which limited purpose alone the MRTP Act will continue to have validity). Upon the expiry of the two year time frame, the MRTP Commission shall stand dissolved and all cases pending before it shall be transferred either to the Competition Appellate Tribunal or the National Commission constituted under the Consumer Protection Act, 1986 depending upon the nature of the cases. Thus starting September 1, 2009, the MRTP Commission shall no longer be entitled to entertain any new case arising under the MRTP Act. In its place, the Competition Commission of India ("**CCI**") will now be presiding over cases / carrying out investigations under the provisions of the Competition Act, thus ensuring that the MRTP Commission only works towards completing all matters currently pending before it.

Q. WHETHER ALL PROVISIONS OF THE COMPETITION ACT HAVE BEEN NOTIFIED?

A. The substantive provisions of the Competition Act relating to behavioral pattern of the entities viz prohibition of (i) anti competitive agreements and (ii) abuse of dominance have been notified on May 15, 2009 and such provisions shall be effective from May 20, 2009; and the substantive provisions of the Competition Act relating to the Combinations of Mergers, Acquisitions and Amalgamations viz. (i) Combinations (ii) Regulation of Combinations (iii) Inquiry into Combinations by Commission (iv) Procedure for Investigation of Combinations (v) Procedure in case of Notice under Sub-Section (2) of Section 6 (vi) Orders of Commission on certain Combinations have been notified on March 04, 2011 and such provisions have been in effect from June 01, 2011.

Q. WHAT IS THE OBJECTIVE OF THE COMPETITION ACT?

A. The Preamble of the Competition Act states that this is *"an Act to establish a Commission to prevent anti-competitive practices, promote and sustain competition, protect the interests of the consumers and ensure freedom of trade in markets in India."* The Competition Act seeks to:

- prohibit anti-competitive agreements including cartels;
- prohibit abuse of dominant position;
- regulate combinations.

Q. DOES THE COMPETITION ACT HAVE EXTRA-TERRITORIAL REACH?

A. Section 32 of the Competition Act expressly provides for extra-territorial reach of the statute. Any anti-competitive activity taking place outside India but having an AAEC within India shall be subjected to the application of the Competition Act. The Competition Act gives power to the CCI to enquire into any agreement, abuse of dominant position or combination having an AAEC in the relevant Indian market, notwithstanding that:

- an anti competitive agreement has been entered into outside India; or
- any party to such agreement is outside India; or
- any enterprise abusing the dominant position is outside India; or

- a combination has taken place outside India; or
- any party to combination is outside India; or
- any other matter or practice or action arising out of such agreement or dominant position or combination outside India, if such agreement or dominant position or combination has, or is likely to have, an AAEC in the relevant market in India.

Part II: Anti Competitive Agreements

Q. WHAT IS AN "AGREEMENT" UNDER THE COMPETITION ACT?

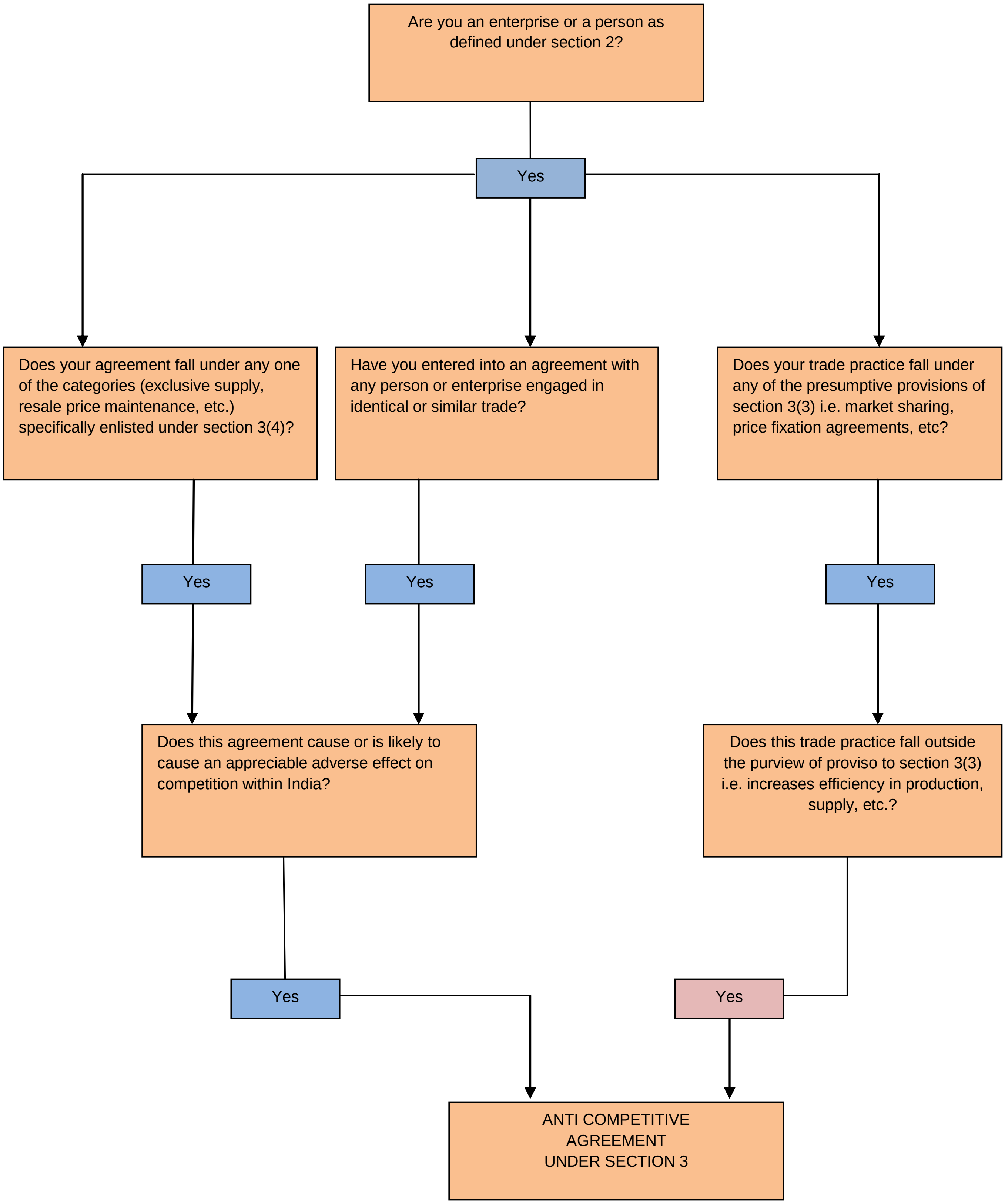
A. Section 2(b) of the Competition Act defines an agreement to include any arrangement, understanding or concerted action entered into between parties. It need not be in writing or formal or intended to be enforceable in law.

Q. WHAT IS AN ANTI COMPETITIVE AGREEMENT?

A. Section 3(1) of the Competition Act provides that no enterprise or a person shall enter into an agreement, which causes or is likely to cause an AAEC within India. It is further clear from the provision that if an agreement does not have any AAEC then it will remain out of the purview of this provision. The term 'appreciable adverse effect on competition', used in section 3(1) has not been defined in the Competition Act. However, Section 19(3) of the Competition Act states that while determining whether an agreement has an AAEC, CCI shall have due regard to all or any of the following factors:

- creation of barriers to new entrants in the market;
- driving existing competitors out of the market;
- foreclosure of competition by hindering entry into the market;
- accrual of benefits to consumers;
- improvements in production or distribution of goods or provision of services;
- promotion of technical, scientific and economic development by means of production or distribution.

On an analysis of the provisions of the Competition Act, for an agreement to be anti-competitive, the following shall be satisfied:



* If the answer to any of the above is “No”, the agreement would not be considered anti-competitive

There are certain categories of agreements, which have been mentioned under Section 3(3) of the Competition Act, which are presumed to be *per se* illegal as it causes an AAEC in India. However, there is a carve out provided to such agreements under proviso to Section 3(3) of the Competition Act which provides that such agreements shall not be considered as *per se* illegal if such agreements increase efficiency in production, supply, distribution, storage, acquisition or control of goods or provision of services

Horizontal Agreements, which are considered *per se* illegal, are:

- agreement to fix prices;
- agreement to limit production and/or supply of goods or provision of services;
- agreement to allocate markets;
- bid rigging or collusive bidding.

Vertical Agreements, which are mentioned under the Competition Act, are:

- <u>conditional purchase/ sale (tie-in arrangement)</u> which includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods;
- <u>exclusive supply arrangement</u> which includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person;
- <u>exclusive distribution arrangement</u> which includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of the goods;
- <u>refusal to deal</u> which includes any agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought; and
- <u>resale price maintenance</u> which includes any agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged.

The vertical agreements mentioned above are void only in the event such agreement causes an AAEC within India. The other kinds of horizontal agreements and vertical agreements are tested on the principle of *rule of reason* where the CCI shall judge whether such agreements cause an AAEC within India.

Q. ARE THERE ANY EXCEPTIONS TO THE PROVISIONS OF ANTI COMPETITIVE AGREEMENTS?

A. The provisions relating to anti competitive agreements will not restrict the right of any person to restrain any infringement of intellectual property rights or to impose such reasonable conditions as may be necessary for the purposes of protecting any of its rights which have been or may be conferred upon it under the following intellectual property right statutes;

- the Copyright Act, 1957;
- the Patents Act, 1970;
- the Trade and Merchandise Marks Act, 1958 or the Trade Marks Act, 1999;
- the Geographical Indications of Goods (Registration and Protection) Act, 1999;
- the Designs Act, 2000;
- the Semi-conductor Integrated Circuits Layout-Design Act, 2000.

Another exception to the applicability of the provisions relating to anti competitive agreements is the right of any person to export goods from India, to the extent to which, an agreement relates exclusively to the production, supply, distribution or control of goods or provision of services for such export.

Q. WHAT IS A CARTEL?

A. Cartel has been defined under the Competition Act to "*include an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services*".

A cartel is regarded as the most pernicious form of violation of competition law and is subject to the most severe penalties under the law. Under general legal parlance, cartels are agreements which are formed in secrecy, which may or may not be in writing, between firms in direct competition with one another in the relevant market, which result in profits due to unreasonable increase of prices by the cartel at the cost of exploitation of the customers. Under the extant MRTP Act, the MRTP Commission can only pass cease and desist orders to stop the operation of any cartels. However, under the Competition Act, the CCI, apart from passing cease and desist orders, can also impose heavy fines.

Q. ARE THERE ANY SAFE HARBOR PROVISIONS UNDER THE COMPETITION ACT?

A. The Competition Act provides for imposition of a lesser penalty, if any producer, seller, distributor, trader or service provider included in any cartel, which is alleged to have violated the provisions of the Competition Act, with respect to anti competitive agreements,

- has made a <u>full and true disclosure</u> in respect <u>of the alleged violation</u>;
- such disclosure is vital;
- such party continues to <u>co-operate with the CCI</u> till the completion of the proceedings before the CCI;
- has not concealed, destroyed, manipulated or removed the relevant documents in any manner, that may contribute to the establishment of a cartel.

A further condition is that the disclosure should be made before the report of the investigation by the Director General, as directed by the CCI, has been received. The leniency provision has proved to be a powerful tool in the hands of competition authorities in detecting and investigating cartels and proving their existence. The provision has also served to seriously destabilize cartels and provide an incentive to parties to disclose cartel's existence to the competition authorities.

Further, the Lesser Penalty Regulations, 2009 promulgated by the CCI on August 13, 2009 provides that:-

- The applicant may be granted benefit of reduction in penalty up to or equal to 100%, if the applicant is the first to make a vital disclosure by submitting evidence of a cartel;
- The applicant marked as second in the priority status may be granted reduction of monetary penalty up to or equal to 50% of the full penalty leviable; and
- The applicant marked as third in the priority status may be granted reduction of monetary penalty up to or equal to 30% of the full penalty leviable.

<u>Part III: Abuse of Dominance</u>

Q. WHAT CONSTITUTES A POSITION OF DOMINANCE?

A. Dominance refers to a position of strength that enables an enterprise to operate independently of competitive forces or to affect its competitors or consumers or the market in its favor.

There are various criteria laid down under the Competition Act, based on which the CCI shall conclude whether an enterprise enjoys dominant position which *inter alia* includes:

- market share of the enterprise;
- size and resources of the enterprise;
- size and importance of the competitors;
- economic power of the enterprise including commercial advantages over competitors;
- vertical integration of the enterprises or sale or service network of such enterprises;
- dependence of consumers on the enterprise; entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale;
- high cost of substitutable goods or service for consumers;
- countervailing buying power;
- market structure and size of market;
- any other factor which the CCI may consider relevant for the inquiry.

Q. WHAT CONSTITUTES ABUSE OF DOMINANCE?

A. Abuse of dominant position is a situation where an enterprise that enjoys dominant position directly or indirectly, imposes unfair or discriminatory conditions in the purchase or sale of goods or service; or imposes unfair or discriminatory prices in purchase or sale (including predatory price) of goods or services.

An abuse of dominant position includes situations of imposing unfair conditions or price, predatory pricing which is defined as the situation where a firm with market power prices below cost so as to drive the competitors out of the market and acquire or maintain a position of dominance, limiting production/market or technical development, creating barriers to entry, applying dissimilar conditions to similar transactions, denying market access, and using dominant position in one market to gain advantages in another market.

Q. WHAT ORDERS CAN THE CCI PASS IN CASE OF ANTI COMPETITIVE AGREEMENTS AND ABUSE OF DOMINANT POSITION?

A. The following can be passed by CCI in case of anti competitive agreement and abuse of dominant position:

- during the course of inquiry, the CCI can pass interim order restraining a party from continuing with anti competitive agreement or abuse of dominant position.
- impose a penalty up to 10% of the average turnover for the last three preceding financial years of the enterprise. In case of a cartel, the CCI can impose on each member of the cartel, a penalty of up to three times its profit for each year of the continuance of such agreement or up to 10% of its turnover for each year of continuance of such agreement, whichever is higher.
- may direct, after the inquiry, a delinquent enterprise to discontinue and not to re-enter anti-competitive agreement or abuse its dominant position (cease and desist order). The CCI may also direct modification of such agreement.
- may direct division of enterprise in case it enjoys dominant position.

<u>Part IV: Combinations</u>

Q. WHAT IS A COMBINATION UNDER THE COMPETITION ACT?

A. Combination includes acquisition of control, shares, voting rights or assets, acquisition of control by a person over an enterprise where such person has control over another enterprise engaged in competing businesses, and mergers and amalgamations between or amongst enterprises where these exceed the thresholds specified in the Competition Act in terms of assets or turnover. If a combination causes or is likely to cause an AAEC within the relevant market in India, it is prohibited and can be scrutinized by the CCI.

However, the Competition Act clearly provides that the provisions with respect to combinations are not applicable to share subscription or financing facility of any acquisition by a public financial institution, foreign institutional investors, banks or venture capital fund pursuant to any covenant of a loan agreement or investment agreement. However, such provisions shall not apply only when within 7 days from the date of such acquisition, the parties to such share subscription or financing facility file Form 3 as prescribed with the CCI providing for:

- the details of acquisition including the details of control;
- the circumstances for exercise of such control;
- consequences of default arising out of such loan agreement of investment agreement, as the case may be.

Q. WHAT ARE THE TYPES OF MERGERS?

A. Mergers are broadly classified into three categories:

- Horizontal mergers, which take place between competitors which produce or supply similar or identical products;
- Vertical mergers, which take place between enterprises at different levels in the chain of production, distributors etc. like manufacturers and distributors;
- Conglomerate mergers, which take place between enterprises engaged in unrelated business activities.

Q. WHAT ARE THE THRESHOLDS IN CASE OF COMBINATIONS?

A. The thresholds for the joint assets/turnover are presented in the form of a table below:

Type of combination	For the Parties		For the Group	
	In India	**World-wide**	**In India**	**World-wide**
Acquisitions, Mergers, Amalgamations, Dominant Position	Assets – INR 15 billion (~USD 333 million) or Turnover - INR 45 billion (~USD 1 billion)	Assets - USD 750 million or Turnover - USD 2250 million; and In India Assets – INR 7.5	Assets - INR 60 billion (~USD 1.3 billion) or Turnover – INR 180 billion (~USD 4 billion)	Assets - USD 3 billion or Turnover - USD 9 billion; and In India

		billion (~USD 167 million) or Turnover – INR 22.5 billion (~USD 500 million)		Assets – INR 7.5 billion (~USD 167 million) or Turnover - INR 22.5 billion (~USD 500 million)

(For reference: 1 USD = INR 50)

For the purposes of calculating the threshold limits, a "**group**" means two or more enterprises, which directly or indirectly have:

- The ability to exercise 50% or more of the voting rights in the other enterprise; or
- The ability to appoint more than half the members of the board of directors in the other enterprise; or
- The ability to Control the affairs of the other enterprise.

Control (which expression occurs in the third bullet defining 'group' above), has also been defined in the Competition Act. Control includes controlling the affairs or management by:

- one or more enterprises, either jointly or singly, over another enterprise or group;
- one or more groups, either jointly or singly, over another group or enterprise.

Q. DOES A FIRM PROPOSING TO COMBINE HAVE TO NOTIFY THE CCI?

A. A firm proposing to enter into a combination, shall notify the CCI in the specified form disclosing the details of the proposed combination within 30 days of the approval of the merger or amalgamation by the board of directors of the enterprises concerned with such merger or amalgamation or execution of any agreement or other document evidencing acquisition of control.

Q. IS THERE COMPULSORY WAITING PERIOD FOR A COMBINATION TO TAKE EFFECT?

A. Yes. The proposed combination cannot take effect for a period of 210 days from the date it notifies the CCI or till the CCI passes an order, whichever is earlier.

If the CCI does not pass an order during the said period of 210 days the combination shall be deemed to have been approved.

Q. WHAT IS THE PROCEDURE FOR INVESTIGATION OF COMBINATIONS?

The schematic delineation for the procedure for investigation into combination is provided below:

CCI takes a prima facie view that the combination has an AAE in India

↓

…contd.

Issue a show cause notice to the parties to respond within 30 days as to why investigations should not be commenced against them with respect to the combination

CCI may call for a Report from the Director General of the CCI with respect to the combination

On receipt of the response from the combining parties, the CCI shall direct the parties to publish information pertaining to the combination to inform the general public.

The details of the combination shall be published within 10 days of the direction by the CCI in a manner such that persons affected or likely to be affected by the combination are informed of the details of the combination

Written objection to the combination if invited by the CCI shall have to be provided within 15 days from the date of publication of details of the combination by the combining parties

The CCI may direct the parties to furnish such additional information regarding the combination as it may deem fit, which is required to be furnished by the enterprises within 15 days from the date of such direction

On receipt of the response from the combining parties, the CCI shall direct the parties to publish information pertaining to the combination so as to inform the general public of the details of the combination

On receipt of such additional information sought, the CCI will have to make its determination as to whether the combination is to be allowed, disallowed or modified within a period of 45 days

If the CCI suggests modifications to the scheme of combination and the parties to the combination accept the same, the modifications shall have to be carried out by the parties within the time period as suggested by the CCI. In the event the parties do not agree with the modifications suggested by the CCI, the parties shall submit their suggested modifications to the CCI within 30 days from the date of receipt of suggestions from the CCI.

Q. WHAT ARE THE CRITERIA THAT CCI SHALL LOOK AT TO CONCLUDE THAT A COMBINATION HAS AN AAEC?

A. The mergers or acquisitions shall be refused by the CCI if the merger creates a situation wherein the effect may be to substantially lessen competition or which tends to create a monopoly. The Competition Act has listed the following factors to be taken into account for the purpose of determining whether the combination would have the effect of or be likely to have an AAEC:

- The actual and potential level of competition through imports in the market;
- The extent of barriers to entry to the market;
- The level of combination in the market;
- The degree of countervailing power in the market;
- The likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;
- The extent of effective competition likely to sustain in a market;
- The extent to which substitutes are available or are likely to be available in the market;
- The market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;
- The likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;
- The nature and extent of vertical integration in the market;
- The possibility of a failing business;
- The nature and extent of innovation;
- Relative advantage, by way of the contribution to the economic development, by any combination having or likely to have AAEC;
- Whether the benefits of the combination outweigh the adverse impact of the combination, if any.

Q. ARE THERE ANY EXEMPT TRANSACTIONS WHICH DO NOT REQUIRE APPROVAL FROM CCI?

A. Schedule I to the Combination Regulations specifies certain categories of transactions which are *ordinarily* not likely to have an AAEC and therefore would not *normally* require to be notified to the CCI which *inter alia* include

- Acquisitions of shares or voting rights as an investment or as an investment in so far as the total shares or voting rights held by the acquirer directly or indirectly does not exceed 15% of the total shares or voting rights of the company.
- Consolidation of holdings in an entity where the acquirer already had 50% or more shares or voting rights except in cases where the transaction results in a transfer from joint control to sole control.
- An acquisition of assets unrelated to the business of the acquirer other than an acquisition of a substantial business operation.
- Acquisitions of stock-in-trade, raw materials, stores, current assets (in the ordinary course of business).
- Acquisitions of bonus or rights shares, not leading to acquisition of control.
- Combinations taking place entirely outside India with insignificant local nexus and effect on markets in India.

Q. ARE THERE ANY ENTERPRISES THAT ARE EXEMPT FROM THE SCOPE OF THE COMPETITION ACT IN CASE OF A COMBINATION?

A. An enterprise whose shares, control, voting rights or assets are being acquired has assets of the value of not more than INR 250 crores (approx. USD 56 million) in India or turnover of the value of not more than INR 750 crores (approx. USD 160 million) in India is exempt from the provisions of Section 5 of the Competition Act till March 4, 2016.

Q. WHAT ORDERS CAN THE CCI PASS IN CASE OF A COMBINATION?

A. The CCI can pass the following orders:

- approve the combination in the event that the CCI is of the opinion that there is no AAEC.
- disapprove of combination in the event that the CCI is of the opinion that there is an AAEC.
- In the event that the CCI is of the opinion that there is an AAEC but the AAEC can be eliminated by suitable modifications, CCI shall propose such suitable modifications to the scheme which shall be carried out by the parties to such combination within a specified time frame. The parties to the combination who accept the modification proposed by the CCI shall carry out such modification within the period specified by the CCI. In the event that the parties to the combination, who have accepted the modification fail to carry out the modification within such prescribed time period, such combination shall be deemed to have an AAEC.
- If the parties to the combination do not accept the modification proposed by the CCI such parties may, within 30 working days of the modification proposed by the CCI, submit amendment to the modification proposed by the CCI. In the event the CCI agrees with the amendment submitted by the parties, it shall approve the combination. If the Commission does not accept the amendment, then, the parties shall be allowed a further period of 30 working days within which such parties shall accept the modification proposed by the CCI. If the parties fail to accept the modification proposed by the CCI within 30 working days or within a further period of 30 working days, the combination shall be deemed to have an AAEC.

Q. IS THERE ANY POSSIBILITY OF CONFLICT BETWEEN THE PROVISIONS OF THE COMPETITION ACT VIS-À-VIS OTHER INDIAN LAWS AND REGULATIONS?

A. Section 60 of the Competition Act states that the provisions of the Competition Act shall override all other provisions contained in any law. However, Section 62 states that the provisions of the Competition Act are in addition to and not in derogation of any other law. Thus, applying the principle of harmonious construction, where there is a direct conflict between the provisions of the Competition Act and any other law, the former shall prevail, and where there is no repugnancy, provisions of both laws shall apply together. In situations wherein there is a conflict between the Competition Act and any other law which other law also has a “non obstante” clause, either an amendment in the law will be necessary, or a judicial proceeding will be required to resolve the conflict.

- **Companies Act, 1956**

  Sections 391–394 of the Companies Act, 1956 govern reconstructions and amalgamations of companies. The Companies Act requires the high court of appropriate jurisdiction to approve the merger and sanction the same which is said to usually take 4-6 months.
  However, the maximum time that can be taken by CCI under the Competition Act is 210 days, which can be extended further under certain conditions. This would mean that the CCI could legally utilize the

maximum time period available to it, thereby further extending the time period within which mergers may be sanctioned by the various regulatory authorities.

Thus, an issue that can arise on the concurrent review of the Companies Act and the Competition Act is that, the Competition Act empowers the CCI and Companies Act empowers the high court to make modifications to the scheme of merger/arrangement and a modification made by either of the regulators viz. CCI or high court would render the review undertaken by the other infructuous.

- **Takeover Code**

The approval period of 210 days provided for in the Competition Act would impose additional financial obligations of the acquirer when the combination triggers open offer under the Indian Takeover Code.

When the acquirer is unable to pay the shareholders participating in the open offer within 15 days from the date of closure of the offer owing to non-receipt of any statutory approval, the extension of time to make such payment is subject to the acquirer agreeing to pay interest to the shareholders for the delayed payment.
CCI is entitled to a time period of 210 days to form its opinion, which could obligate the acquirer to pay interest to the shareholders under most circumstances, if the two enactments are triggered simultaneously.

- **Preferential allotment guidelines**

A practical difficulty arises in cases of preferential allotments that are governed by Chapter VII of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 commonly known as ICDR Regulations which provide that preferential allotment needs to be completed within 15 days from the date of passing of the resolution.

In case the allotment is pending regulatory approval, the same will have to be completed within 15 days of such approval. As mentioned above, the CCI is entitled to 210 days to approve/disapprove the combination. In such circumstances, the potential investor could be allotted shares at a price determined on the date which could be seven months older than the date on which allotment is made.

- **Telecom Sector**

One of the primary functions of the Telecom Regulatory Authority of India ("**TRAI**"), India's telecom regulator, is to create conditions for growth of telecommunications in India and provide a fair and transparent policy environment which promotes a level playing field and facilitate fair competition as provided under the TRAI Act, 1997 (the "**TRAI Act**").It is pertinent to note that based on TRAI's recommendations, on April 22, 2008 the Department of Telecommunications ("**DoT**") issued revised guidelines ("**Guidelines**") for intra-service area merger of Cellular Mobile Telephone Service/Unified Access Services ("**CMTS/UAS or Licenses**") superceding the earlier guideline issued in 2004[2]. Thus, there is a possibility of an overlap of the regulatory framework between the DoT and the CCI. The Guidelines issued by the DoT provides that the combined market share of any merged entity shall not be more than 40%. The Guidelines also provide that no merger shall be allowed if the number of service providers reduces to less than four in the relevant market. In light of Section 60 of the Competition Act, the DoT Guidelines will be in addition to the provisions of the Competition Act, and any provision which is repugnant to the provisions of the Competition Act will be redundant in light of Section 62 of the

[2] Guideline No. 20-100/2007-AS-1 issued by the DoT, issued on April 22,2008 ("DoT Guideline")

Competition Act, which provides that the legislation is in addition to other laws and not in derogation of other existing laws.