Cross Border Mergers and Acquisition with Support of Competition Act and FEMA

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ABSTRACT

The term 'merger', 'demerger', 'amalgamation', 'consolidation', 'reconstruction', 'restructuring', 'arrangement', 'takeover' and 'acquisition' denote certain significant aspects of corporate reorganization. The merger or amalgamation is an organic unification or fusion of two or more legal entities or undertakings or separation of one from the other[1].

Indian outbound deals, which were valued at US$ 0.7 billion in 2000-01, increased to US$ 4.3 billion in 2005, and further crossed US$ 15 billion-mark in 2006. In fact, 2006 will be remembered in India's corporate history as a year when Indian companies covered a lot of new ground. They went shopping across the globe and acquired a number of strategically significant companies. This comprised 60 per cent of the total mergers and acquisitions (M&A) activity in India in 2006. And almost 99 per cent of acquisitions were made with cash payments.

The sectors attracting investments by Corporate India include metals, pharmaceuticals, industrial goods, automotive components, beverages, cosmetics and energy in manufacturing; and mobile communications, software and financial services in services, with pharmaceuticals, IT and energy being the prominent ones among these.

Indian economy is proving itself highly conducive to foreign investment[2]*. While the government policies supporting foreign investment have led to a renewed interest by foreign investors and the consequent flow of overseas funds into India, the consequential domestic economic growth has enabled the Indian entrepreneurs to come out and explore business avenues on a global level.*

Keywords

Merger, Acquisition, Corporate, Reconstruction

1 Seth Dua & Associates, *Joint Ventures & Mergers and Acquisitions in India, Legal and Tax Aspects,* LexisNexis Butterworths, New Delhi, 2006, p. 221-222.

2 Anjali Agarwal, Inbound Investments Into India - Structuring the Deal!, (2009) 24 (7) JIBLR 375.

INTRODUCTION

Cross-border Merger and Acquisition activity has started booming again after the world economy has regained its strength from the severe recession of 2007 – 2009 which is termed as Late 2000's Recession[3]. In 2005, Europe saw a 58 percent surge in transnational deals; in Japan, cross-border M&A jumped 21 percent, and in India the rise was a staggering 68 percent. In the year 2008 the United Nation's Agency, United Nations Conference on Conference on Trade and Development (UNCTAD) declared India as the most promising destination for foreign direct investment in the medium-to-long term[4]. With this India has left behind China after eighteen years of opening up its economy.

3 The late-2000s recession or sometimes the Great Recession is an economic recession that began in the United States in December 2007 and with much greater intensity since September 2008, according to the National Bureau of Economic Research. It spread too much of the industrialized world, and has caused a pronounced deceleration of economic activity. This global recession has been taking place in an economic environment characterized by various imbalances and was sparked by the outbreak of the financial crisis of 2007–2010. Although the late-2000s recession has at times been referred to as "the Great Recession," this same phrase has been used to refer to every recession of the several preceding decades. In July 2009, it was announced that a growing number of economists believed that the recession may have ended. Available at <http://en.wikipedia.org/wiki/Late-2000s_recession> as viewed on 16.10.2010 at 2:00 IST.

4 In comparison to 1990-2000 session, the years 2004-2007 had been very profitable for India as far as the inflows and outflows of foreign direct investment is concerned, claimed the report. From an average annual inflow of $1,705 billion in 1990-2000 sessions, it reached a whopping $22,950 billion in 2007. The above statistics clearly reveal the growth and expansion of Indian economy which will maintain the same upward trend in the forth-coming years. Available at <http://www.india-server.com/news/india-top-fdi-destination-unctad-3977.html> as viewed on 16.10.2010 at 14:10 IST.

DEFINITIONS

The terms 'Merger' and 'Amalgamation' are used interchangeably to denote the fusion or combination of two or more companies into a single company, where one survives and the other(s) lose its/their corporate entity; thus being dissolved/wound up without the process of winding up and the process is carried out through a scheme requiring sanction of the Court. Merger means merging or combining of two or more companies engaged, generally, in the same line of business for different reasons. Merger may take place in the form of amalgamation or absorption. Demerger of a company signifying a movement in the company just opposite to combination in any of the forms defined in the previous chapter. It means a division of company takes place when part of its undertaking is transferred to a newly formed company or to an existing company, some or all of whose shares are allotted to some or all of the first company's shareholders. The remainder of the first company's undertaking continues to be vested in it and its shareholders are reduced to those who do not take shares in the other company; in other words, the company's undertaking and shareholders are divided between the two companies. In the following definitions, the definitions given by the Income Tax Act, 1961 are dealt with.

Definition of Amalgamation

Amalgamation is an arrangement or reconstruction. It is a legal process by which two or more companies are to be absorbed or blended with another. As a result, the amalgamating company loses its existence and its shareholders become shareholders of new company or the amalgamated company. In case of amalgamation a new company may came into existence or an old company may survive while amalgamating company may lose its existence

According to Halsbury's law of England amalgamation is the blending of two or more existing companies into one undertaking, the shareholder of each blending companies becoming substantially the shareholders of company which will carry on blended undertaking. There may be amalgamation by transfer of one or more undertaking to a new company or transfer of one or more undertaking to an existing company. Amalgamation signifies the transfers of all are some part of assets and liabilities of one or more than one existing company or two or more companies to a new company[5].

The Accounting Standard, AS-14, issued by the Institute of Chartered Accountants of India has defined the term amalgamation by classifying (i) Amalgamation in the nature of merger, and (ii) Amalgamation in the nature of purchase.

Amalgamation in the Nature of Merger

As per AS-14, an amalgamation is called in the nature of merger if it satisfies all the following condition.

All the assets and liabilities of the transferor company should become, after amalgamation; the assets and liabilities of the other company

The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity share in the transferee company, except that cash may be paid in respect of any fractional shares.

The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

No adjustment is intended to be made in the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies

Amalgamation in the Nature of Purchase

Amalgamation in the nature of purchase is where one company's assets and liabilities are taken over by another and lump sum is paid by the latter to the former. It is defined as the one which does not satisfy any one or more of the conditions satisfied above.

As per Income Tax Act, 1961, merger is defined as amalgamation under sec.2 (1B) with the following three conditions to be satisfied:

i. All the properties of amalgamating company(s) should vest with the amalgamated company after amalgamation.

ii. All the liabilities of the amalgamating company(s) should vest with the amalgamated company after amalgamation.

iii. Shareholders holding not less than 75% in value or voting power in amalgamating company(s) should become shareholders of amalgamated companies after amalgamation

Amalgamation does not mean acquisition of a company by purchasing its property and resulting in its winding up. According to Income tax Act, exchange of shares with 90%of shareholders of amalgamating company is required.

[5] As viewed at <http://www.mbaknol.com/management-concepts/amalgamation-definition/> on 10.02.2017.

Definition of Acquisition

An acquisition, also known as a takeover, is the buying of one company (the 'target') by another. An acquisition may be friendly or hostile. In the former case, the companies cooperate in negotiations; in the latter case, the takeover target is unwilling to be bought or the target's board has no prior knowledge of the offer. Acquisition usually refers to a purchase of a smaller firm by a larger one. Sometimes, however, a smaller firm will acquire management control of a larger or longer established company and keep its name for the combined entity. This is known as a reverse takeover.

Distinction between Mergers and Acquisitions

The terms merger and acquisition mean slightly different things

When one company takes over another and clearly established itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist, the buyer "swallows" the business and the buyer's stock continues to be traded.

In the pure sense of the term, a merger happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals". Both companies' stocks are surrendered and new company stock is issued in its place. For example, both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, DaimlerChrysler, was created.

In practice, however, actual mergers of equals don't happen very often. Usually, one company will buy another and, as part of the deal's terms, simply allow the acquired firm to proclaim that the action is a merger of equals, even if it is technically an acquisition. Being bought out often carries negative connotations, therefore, by describing the deal as a merger, deal makers and top managers try to make the takeover more palatable.

A purchase deal will also be called a merger when both CEOs agree that joining together is in the best interest of both of their companies. But when the deal is unfriendly - that is, when the target company does not want to be purchased - it is always regarded as an acquisition.

When Merger and Acquisition Promise Fails to Deliver?

Every merger, acquisition, or strategic alliance promises to create value from some kind of synergy, yet statistics show that the benefits that look so good on paper often do not materialize. Unfortunately, many mergers and acquisitions fail to meet their objectives, which are typically to accelerate growth, cut costs, increase market share or take advantage of other synergies.

In simple way I can say that "Merger & Acquisition is just like a marriage, interesting poin there is that upwards of 60% of these mergers fail to deliver on share holder expectations. But when M&As succeed, they can lay the foundation for a company to be the leader in its sector. Ignorance, Poor governance, Poor communication, Weak leadership

REASONS OF MERGERS AND ACQUISITIONS

1. **Revenues:** By combining the two companies, we will realize higher revenues then if the two companies operate separately.

2. **Expenses:** By combining the two companies, we will realize lower expenses then if the two companies operate separately.

3 **Cost of Capital:** By combining the two companies, we will experience a lower overall cost of capital

A combined company can reduce its fixed cost and so can reduce the cost of the production and can be fitted with the economies of large scale

If the buyer is purchasing a competitor from the market it will definitely reduce the competition.

CROSS BORDER MEGER AND COMPETETION IN INDIA

The Indian corporate landscape has been dominated by two types of corporate i.e. Public Sector Undertakings (owned by Union or State Government) and Private Corporations. The architect of Indian economy after independence adopted the policies known as ―Command-and-Control‖. These policies were implemented through five yearly plans, 1st of which was presented to the Parliament of India on December 8, 1951 by the first Indian Prime Minister of India, Sh. Jawaharlal Nehru. Ever since then eleven five year plans have been formulated, latest of which is Eleventh Five-Year Plan (from 2007–2012)[6]

A merger, which term is used in this article interchangeably with amalgamation, may be effected for a number of reasons, some stated and some not stated to anyone outside the management of the companies that are the subject of the proposal for merger. The standard reason given supporting the proposal is that it would enable

[6] Eleventh Five Year Plan 2007-12, Oxford University Press

rationalization of operations or advance synergies in management[7]. One of the unstated reasons could be acquisition of control over the markets to which the merging company would be supplying. The bonafide reason for considering a proposal should be that it is an inexpensive means of entering into a new activity. Before the Competition Act, 2002 [as amended now by the 2007 Act][8], entered into force, a merger of two or more companies had to be decided only under the Companies Act, 1956, ["the 1956 Act"] and in the case of listed companies, the acquisition of shares was to be approved by the Securities and Exchange Board of India ["SEBI"] also.

The objective of SEBI is only to ensure that acquisition of shares or voting rights in or control of a target company is done in an open manner, equitable to the shareholders and the public investors.

Economic Aspects of Mergers with some Examples

In the economic aspect of Cross Border M&As there can be mergers as well as demergers in the public sector and private sector. Mergers and demergers in the public and private sectors have been discussed here with some of the examples from the India.

1) Mergers in the Public Sector

Air India merger that was considering by the government was with the view to consolidate the position of the Indian state run aviation behemoths so that they compete in the highly competitive global markets. The aim was "one company, one culture." The purpose behind the merger was to create a monolith that would be better positioned to take on global competition; besides, with Air India keen on joining a global aviation alliance, the merger was intended to provide additional benefits to passengers including access to far-flung areas of the country currently not served by any domestic airline or not properly connected by the airways. The mechanism of this merger was to have a human face with a judicious decision taken on the front of the employees of both the companies.

2) Mergers in the Private Sector

Private Banks are taking to the consolidation route in a big way. The recent development over the takeover of the Maharashtra based Sangli Bank with the largest private sector bank of our country-ICICI Bank is a crucial development for the banking sector of our country. This merger will give a boost to the ambitions of the ICICI Bank to penetrate the rural sector in a substantial manner along with amassing a human resource pool that is adept at handling the rural sector banking transactions.

Bank of Punjab (Bop) and Centurion Bank (CB) have been merged to form Centurion Bank of Punjab (CBP). RBI has approved merger of Centurion Bank and Bank of Punjab effective from October 1, 2005. The merger is at a swap ratio 9:4 and the combined bank is called Centurion Bank of Punjab with the merged entity having a presence of 240 branches and extension counters, 386 ATMs, about 2.2 million customers.

Examining the Effect of the Combination on Competition

Section 6[l] prohibits a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India.

The first step is the delineation of the relevant market. Then the key issue that will have to be determined is the effect on competition of the proposed merger in the relevant market. In simple terms the question is whether it will eliminate or reduce competition in the market for goods or services supplied by enterprises involved in the combination.

Section 19[6] and [7] set out the factors to be considered while determining the "relevant geographic market" and the "relevant product market" respectively. Under section 19 [6] the following will aid defining the market in which it will have to be ascertained whether there has been either an elimination of competition or reduction of competition: (a) regulatory trade barriers; (b) local specification requirements; (c) national procurement policies; (d) adequate distribution facilities; (e) transport costs; (f) language; (g) consumer preferences, (h) need for secure or regular supplies or rapid after sales service. Section 19[7]:

[7] References in this article to the Competition Act, 2002 will mean the Competition Act 2002 as amended by the Competition (Amendment) Act, 2007 (Act 39 of 2007).

[8] As the law stands at present, there are no express provisions in the Companies Act, 1956 permitting a company falling under section 3 of that Act to merge with a transferee company not registered in India. And section 390(a) defines that in sections 390 and 393 the expression "company" means any company liable to be wound up under the Act. On this aspect, the Irani Committee has recommended at paragraph 22 of its Report as follows: "The present Act does not permit this form of merger in view of the specific definition of company under section 390(a) of the Companies Act. The Committee noted that apart from amendments to the Companies Act, suitable changes may be necessary in the Income Tax Act, Foreign Exchange Management Act and provisions relating to IDR to enable merger of an Indian Company with foreign entity. The Committee therefore recommended adoption of international best practices and a coordinated approach while bringing amendments to the code of merger in the Companies Act."

(a) physical characteristics or endues of goods, (b) price of goods or service; (c) consumer preferences; (d) exclusion of in-house production; (e) existence of specialized producers; (f) classification of industrial products.

Section 20[4] of the Act states that the Commission shall have due regard to all or any of the following factors, for the purposes of determining whether a combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market:

(a) actual and potential level of competition through imports in the market; (b) extent of barriers to entry into the market; (c) level of combination in the market; (d) degree of countervailing power in the market; (e) likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins; (f) extent of effective competition likely to sustain in a market; (g) extent to which substitutes are available or are likely to be available in the market; (h), market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination; (i) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market; j) nature and extent of vertical integration in the market; (k) possibility of a failing business; (l) nature and extent of innovation; (m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition; (n) whether the benefits of the combination outweigh the adverse impact of the combination, if any.

Most important of the factors stated in section 20[4] of the 2002 Act are: (f) extent of effective competition likely to sustain in a market; and (i) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market. Clauses [l], [m] and [n] deal with cases which are stated broadly in the last clause viz. whether the benefits of the combination outweigh the adverse impact of the combination, if any.

Acts Taking Place outside India but Having Effects on Competition within India

Section 32 of the 2002 Act empowers the Commission to pass appropriate orders when anti-competitive acts take place outside India, and those acts have their effects in India. Section 32 was amended by the 2007 Amendment Act. The pre-amended section was as follows:

"The Commission shall, notwithstanding that,- (a) an agreement referred to in section 3 has been entered into outside India; or (b) any party to such agreement is outside India; or (c) any enterprise abusing the dominant position is outside India; or (d) a combination has taken place outside India; or (e) any party to combination is outside India; or (f) any other matter or practice or action arising out of such agreement or dominant position or combination is outside India, have power to inquire into such agreement or abuse of dominant position or combination if such agreement or dominant position or combination has, or is likely to have, an appreciable adverse effect on competition in the relevant market in India."

The words in brackets are the amendments. In practice, the only effective manner in which an adverse effect on competition within a country may be rendered inoperative is to restrain, if the overseas party has an office or some representation in India, restrain that party also from giving effect to the proposal. If there is none, the implementation of that proposal in India can be restrained by an order on the Indian enterprise.

The Competition Act, 2002 is mainly brought into existence to regulate the activity of corporate combinations and to prevent any harmful or detrimental agreements that may cause an unfavourable outcome. The main agenda of the Act is to prevent inequity in the Indian market and ensure free and ethical trade. Its role can be likened to that of an umpire in a match, wherein the parties are large conglomerates striving for supremacy and dominance in the industry. The Competition Act, 2002 has been inspired by the UNCITRAL Model Law and the US Anti-Trust Laws.

Keeping in view the mandatory notification process, the question that arises is whether India needs a mandatory merger notification regime after all. The existing legal system in India compels certain corporate combinations to be subjected to review by the Commission even when they have slight or no connection with Indian trade, per se.

The views of financial experts are widely divided as to whether the provisions of the Competition Act, 2002 are progressive or regressive. While the entire purpose of enacting this statute so as to ensure free and fair trade is commendable, the above mentioned provisions tend to cause an impediment in an otherwise smooth process. It is essential and critical for the Competition Commission of India (CCI) to be sensitive to the needs of the parties concerned and it should ensure that the corporate combinations are regulated in a way that certifies national growth, free of any obstructions. Since the Indian market cannot function in isolation, the provisions of the Act need to be reviewed with special emphasis upon foreign investors.

Cross border mergers do not respect any territorial boundaries and thus, international cooperation is extremely imperative to effectively deal with cross-border competition problems, if any.

CROSS BORDER MERGERS & ACQUISITIONS AND FOREIGN EXCHANGE MANAGEMENT ACT, 1999

Due to globalization, liberalization, technological developments and the resultant intensely competitive business environment, Cross Border Mergers and Acquisitions have become very popular throughout the world in the recent times. M&As have historically been the favorite tool used by companies for restructuring of their business.

Though, various reasons for the rapid growth of M&As would be discussed later in this work, it is important to note that the most crucial of all of them has been that due to increasing competition and advanced technology, it has become difficult for companies and other businesses to go forward and it has compelled them to join hands with other parties. In such circumstances, cross border transactions have emerged as good strategy. Cross border M&As are one of the fastest ways of investing abroad and gaining access to companies that are acquired abroad by way of market share.

If one sees the market records of past 25 years, it is apparent that there have been two major waves of cross border M&A transactions. The first wave was witnessed in the late 1980s, while the second, a big cross border buying spree being in the latter half of the 1990s[9]. It is pertinent to note that the global economy experienced relatively high economic growth and widespread industrial restructuring, during both these waves of cross border M&As.

Coming to India, post independence, for about 10 years India was receptive towards foreign investment due to various reasons. Thereafter due to change in policies, India became a closed economy. Hence it became nearly impossible for an Indian business firm to think of inviting foreign investment, leave alone investing abroad. The concept of M&As gained popularity in India, after the government introduced the new economic policy in 1991, thereby paving the way for economic reforms and opening up a whole lot of challenges both in the domestic and international spheres[10].

Every merger or acquisition involves one or more methods of obtaining control of a public or private company, and the legal aspects of these transactions include issues relating to due-diligence, defining the parties' contractual obligations, structuring exit options, and the like. Due to the positive as well as negative impact cross border M&A may have on the economy, every legal system seeks to regulate it. Interestingly, while regulating cross border M&As, the government has to be cautious to avoid any kind of over regulation, as the same may be fatal for the economic development and may result in discouraging foreign investors as well as domestic investors, seeking to acquire foreign companies.

The Indian legal system regulates and governs various aspects of a cross border M&A transaction by a set of laws, most importantly the *Companies Act*, 1956; the Foreign Investment Policy of the government of India along with press notes and clarificatory circulars issued by the Department of Investment Policy and Promotion; *Foreign Exchange Management Act*, 1999 ("FEMA") and regulations made there under, including circulars and notifications issued by the RBI from time to time (hereinafter together referred to as the "FEMA laws"); the Securities and Exchange Board of India Act, 1992 and regulations made there under (hereinafter together referred to as "SEBI laws"); the Income Tax Act, 1961 and the Competition Act, 2002 etc[11].

INBOUND CROSS BORDER MERGERS AND ACQUISITIONS IN INDIA AND THE FEMA LAWS

When we talk about inbound cross border Mergers and Acquisitions in India, we essentially mean foreign investment in India. As stated earlier, foreign investment in India, i.e. investment in India by a "person resident outside India", (hereinafter to be interchangeably used with "non resident") is governed by FEMA Regulations, 2000[12].

Under FEMA Regulations, 2000, general permission has been granted to any non-resident to purchase shares or convertible debentures of an Indian company under Foreign Direct Investment Scheme, subject to the terms and conditions specified in Schedule 1 thereto. However citizens of Bangladesh, Pakistan or Sri Lanka resident outside India and entities in Bangladesh or Pakistan are not permitted to purchase shares or debentures issued by Indian companies or any other Indian security without the prior approval of the RBI.

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[9] Platt Gordon, CROSS-BORDER MERGERS SHOW RISING TREND AS GLOBAL ECONOMY EXPANDS, available at http://findarticles.com/p/articles/mi_qa3715/is_200412/ai_n9466795/

[10] Chaitanya K., INDIAN ECONOMY IN THE NEXT FIVE YEARS: KEY ISSUES AND CHALLENGES, 2005-2009, available at http://ideas.repec.org/a/eaa/aeinde/v4y2004i1_30.html

[11] Premnath Rai, MERGERS AND ACQUISITIONS 2008 - A PRACTICAL INSIGHT TO CROSS-BORDER MERGERS AND ACQUISITIONS, Global Legal Group, available at www.ICLG.co.uk

[12] Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.

Further, persons resident outside India are permitted to purchase shares or convertible debentures offered on a rights basis by an Indian company[13] which satisfies the conditions restated herein below[14]:

i. The offer on right basis does not result in increase in the percentage of foreign equity already approved, or permissible under the Foreign Direct Investment Scheme in terms of FEMA Regulations, 2000;

ii. The existing shares or debentures against which shares or debentures are issued by the company on right basis were acquired and are held by the person resident outside India in accordance with FEMA Regulations, 2000;

iii. The offer on right basis to the persons resident outside India is at a price which is not lower than that at which the offer is made to resident shareholders;

The rights shares so acquired shall be subject to the same conditions regarding repatriation as applicable to original shares[15]. Further, under FEMA Regulations, 2000, an Indian company has been permitted to issue shares to its employees or employees of its joint venture / subsidiary abroad, which are non-resident, either directly or through a trust[16].

Under Regulation 7 of FEMA Regulations, 2000, once a scheme of merger, demerger or amalgamation has been approved by the court, the transferee company (whether the survivor or a new company) is permitted to issue shares to the shareholders of the transferor company who are persons resident outside India, subject to the condition that the percentage of non resident holdings in the company does not exceed the limits for which approval has been granted by the RBI or the prescribed sectoral ceiling under the foreign direct investment policy set under the FEMA laws. If the new share allotment exceeds such limits, the company will have to obtain the prior approval of the FIPB and the RBI before issuing shares to the non residents[17].

FEMA Regulations, 2000 further stipulates that any transfer of security by a resident to a non-resident would require the prior approval of the RBI. For the transfer of existing shares/convertible debentures of an Indian company by a resident to a non resident by way of sale, the transferor will have to obtain the approval of the Central Government before applying to the RBI[18]. In such cases, the RBI may permit the transfer subject to such terms and conditions, including the price at which the sale may be made.

For the purpose of FEMA Regulations, 2000, investment in India by a non-resident has been divided into the following 5 categories and the regulations applicable have been specified in respective schedules as under:

i. Investment under the Foreign Direct Investment Scheme ("the FDI Scheme").

ii. Investment by Foreign Institutional Investors ("FIIs") under the Portfolio Investment Scheme ("the Portfolio Investment Scheme").

iii. Investment by NRIs/OCBs under the Portfolio Investment Scheme.

iv. Purchase and sale of shares by NRIs/OCBs on non-repatriation basis.

v. Purchase and sale of securities other than shares or convertible debentures of an Indian company by non-residents.

REGULATION OF OUTBOUND CROSS BORDER MERGERS AND ACQUISITIONS TRANSACTIONS UNDER FEMA LAWS

As stated, any outbound cross border mergers and acquisitions involving an Indian company, i.e. foreign investment by an Indian company in a foreign company is governed by. There are only certain special circumstances under which an Indian company is permitted to make an investment in a foreign company. An Indian party 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 RBI[19].

There are several routes available to an Indian company which intends to invest in a foreign company, some of which are described herein below:

I) Direct Investment in a Joint Venture/Wholly Owned Subsidiary

RBI has been continuously relaxing the provisions relating to direct investment in a joint venture or a wholly owned subsidiary. Owing to these relaxations the percentage of investment by Indian companies in joint ventures and wholly owned subsidiaries abroad has been continuously rising.

[13] Regulation 6 (1), FEMA REGULATIONS, 2000.
[14] Regulation 6 (2), FEMA REGULATIONS, 2000.
15 Regulation 6 (3), FEMA Regulations, 2000.
[16] Regulation 8, FEMA Regulations, 2000.
[17] Proviso to Regulation 7 (1) (a), FEMA Regulations, 2000.
[18] Regulation 10A (b), FEMA Regulations, 2000.
[19] Regulation 5, FEMA 1999.

General Conditions to be fulfilled for making an Investment

An Indian company is permitted to make a direct investment in a joint venture or a wholly owned subsidiary outside India, without seeking the prior approval of RBI subject to the following conditions being fulfilled[20]:

i. The total financial commitment of the Indian party will be capped at USD 50 Million or its equivalent in a block of 3 financial years including the year in which the investment is made, except investment in a Joint Venture/Wholly Owned Subsidiary in Nepal and Bhutan.

ii. In respect of direct investment in Nepal or Bhutan, in Indian rupees the total financial commitment shall not exceed Indian Rupees 1,200 Million in a block of 3 financial years including the year in which the investment is made;

iii. The Indian company is not on the RBI's caution list or under investigation by the Enforcement Directorate.

iv. The Indian company routes all the transactions relating to the investment in the joint venture or the wholly owned subsidiary through only one branch of an authorized dealer to be designated by it. However the Indian company is permitted to designate different branches of authorized dealer for onward transmission to the RBI.

v. The Indian company files the prescribed Form ODA to the designated branch of the authorized dealer for onward transmission to the RBI.

Sources for Investment

An Indian Party is also eligible to extend a loan or a guarantee to or on behalf of the Joint Venture/ Wholly Owned Subsidiary abroad, within the permissible financial commitment, if the Indian Party has made investment by way of contribution to the equity capital of the Joint Venture[21].

Under Regulation 10, RBI is required to allot a unique identification number for each Joint Venture/Wholly Owned Subsidiary outside India and the Indian party is in turn required to quote such number in all its communications and reports to the Reserve Bank and the authorized dealer[22].

II) Investment in a Foreign Company by ADR/GDR Share Swap or Exchange

An Indian company can also invest in a foreign company which is engaged in the same core activity in exchange of ADRs/GDRs issued to the foreign company in accordance with the ADR/GDR Scheme for the shares so acquired provided that the following conditions are satisfied[23]:

i. The Indian company has already made an ADR/GDR issue and that such ADRs/GDRs are currently listed on a stock exchange outside India.

ii. The investment by the Indian company does not exceed the higher of an amount equivalent to USD 100 Million or an amount equivalent to 10 times the export earnings of the Indian company during the preceding financial year.

iii. At least 80% of the average turnover of the Indian Party in the previous 3 financial years is from the activities/sectors included in Schedule or the Indian Party has an annual average export earnings of at least Indian Rupees1,000 Million in the previous 3 financial years from the activities/sectors included in Schedule 1 to FEMA 19;

iv. The ADR/GDR issue is backed by a fresh issue of underlying equity shares by the Indian company.

v. The total holding in the Indian company by non-resident holders does not exceed the prescribed sectoral cap.

vi. The valuation of the shares of the foreign company is done in the following manner:

   a. If the shares of the foreign company are not listed, then as per the recommendation of an investment banker, or

   b. If the shares of the foreign company are listed then as per the formula prescribed therein.

Within 30 days from the date of issue of ADRs/GDRs in exchange of acquisition of shares of the foreign company, the Indian company is required to submit a report in Form ODG with RBI[24].

III) RBI Approval in Special Cases

In the event that the Indian company does not satisfy the eligibility conditions under Regulations 6, 7 and 8, as stated hereinabove, it may make an application to RBI for

[20] Regulation 6, FEMA 1999.
[21] Regulation 6(5), FEMA 19.
[22] Regulation 10, FEMA 19.
[23] Regulation 8, FEMA 1999.
[24] Regulation 8(2), FEMA 1999.

special approval[25]. Such application for direct investment in Joint Venture/Wholly Owned Subsidiary outside India, or by way of exchange for shares of a foreign company, is to be made in Form ODI, or in Form ODB, respectively. In considering the application, the RBI may take into account the following factors[26]:

i. Prima facie viability of the joint venture/wholly owned subsidiary abroad.

ii. Contribution to external trade and other related benefits.

iii. Financial position and business track record of the Indian company and the foreign company; and

iv. Expertise and experience of the foreign company in the same or related line of activity of the joint venture or the wholly owned subsidiary abroad.

IV) Direct Investment by Capitalization

As per Regulation 11, an Indian Party is also entitled to make direct investment outside India by way of capitalization in full or part of the amount due to the Indian Party from the foreign entity as follows:-

i. Payment for export of plant, machinery, equipment and other goods/software to the foreign entity;

ii. Fees, royalties, commissions or other entitlements of the Indian party due from the foreign entity for the supply of technical know-how, consultancy, managerial or other services, however where the export proceeds have remained unrealized beyond a period of 6 months from the date of export, such proceeds cannot be capitalized without the prior permission of RBI.

V) Transfer by way of Sale of Shares of a JV/WOS

No Indian party is entitled to sell any share or security held by it in a Joint Venture or Wholly Owned Subsidiary outside India, to any person, except as otherwise provided in FEMA laws or with the permission of RBI.

VI) Pledge of Shares of Joint Ventures and Wholly Owned Subsidiaries

Further, FEMA 1999 permits an Indian party to transfer, by way of pledge, shares held in a Joint Venture or Wholly Owned Subsidiary outside India as a security for availing of fund based or non-fund based facilities for itself or for the Joint Venture or Wholly Owned Subsidiary from an authorized dealer or a public financial institution in India[27].

The legal and financial reforms by the government of India since the early 1990's have resulted in substantial growth of the Indian economy. The sea change in trade and investment policies and the regulatory environment in the past decade, including, easing of restrictions on foreign investment and acquisition, and the deregulation and privatization of many industries, has probably been the most significant catalyst for the growth of cross border M&A transactions involving India.

Recently, the press has reported of a decision by RBI that Indian companies merging with overseas firms will continue to be treated as entities resident in the country under FEMA and FEMA will be accordingly amended[28]. It has also clarified that payment by the foreign company to shareholders of listed Indian companies being merged can be made in the form of cash, shares or Indian Depository Receipts ("IDRs") issued by the overseas companies. Further since IDRs in their existing form do not have voting rights, the law has to be changed to incorporate this change. This will be important if the merger involves allotting voting rights to Indian shareholders or some sort of management control.

CONCLUSION

With the increasing Cross Border Mergers and Acquisitions in India, Indian Laws do not recognize Indian Companies merging into foreign companies (the *vice versa* is recognized). Mergers into foreign companies should be recognized as a legal process. FEMA is regulating the cross border mergers and acquisitions. The foreign exchange laws relating to issuance and allotment of shares to foreign entities are contained in The Foreign Exchange Management (Transfer or Issue of Security by a person residing outside India) Regulation, 2000 issued by RBI[29] vides. These regulations contained general provisions for inbound and outbound cross border mergers and acquisitions in India. An important indicator of the same being Indian companies becoming multinational companies by making overseas acquisitions. Indian economy is proving itself highly conducive to foreign

[25] Regulation 9, FEMA 1999.

[27] Regulation 16, FEMA 1999.

[28] Anindita Dey, FEMA TO APPLY TO REVERSE OVERSEAS M&AS, SAYS RBI, Business Standard, 9 October 2009, available at http://www.business-standard.com/india/news/fema-to-apply-to-reverse-overseas-mas-says-rbi/372711/

[29] *Foreign Exchange Management (Transfer or Issue of Security by a person residing outside India) Regulation*, 2000 issued by RBI[29] *vides* Notification No. FEMA 20 /2000-RB dated 3rd May, 2000.

investment[30]. While the government policies supporting foreign investment have led to a renewed interest by foreign investors and the consequent flow of overseas funds into India, the consequential domestic economic growth has enabled the Indian entrepreneurs to come out and explore business avenues on a global level. We believe that India will keep signing on the screen of cross border M&A's and would regain its status of the "Golden Bird". From Hindalco acquiring Novelis, to the Tata's acquiring Corus and now Bharati's acquisition to Zain, Indian companies are continuing their march of establishing a global footprint. Currently, a large chunk of Foreign Direct Investments into India is coming from favourable offshore jurisdictions. The Competition law and FEMA shall face the challenge of balancing the interest of the investors and the revenue authorities.

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[5] Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects under the Antitrust Laws; Baker, Jonathan B. (77 New York law Review. 135 (2002))

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[30] Anjali Agarwal, Inbound Investments Into India - Structuring the Deal!, (2009) 24 (7) JIBLR 375.