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Regulations of Cross-Border Mergers in India

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ABSTRACT

Cross-Border Mergers are the best way for a company to expand its operations by way of extending business oversees as not only does this give the merged entities a wider customer base in an untapped market it also increases the amount of market capitalised by the merged entity. It also saves the entity the cost of research and development that is required in bringing a product to the market. It also allows them to reap the benefits of the goodwill that the other entity might have in another geography and hence saves them the cost of promotion. The due diligence must entail an extensive financial analysis as well as an analysis of the cultures. This is of utmost importance as the entities will exist as one and cultural differences will make that difficult. The compliance of a merger occurring with an Indian company is extensive as it attracts the jurisdictions of a wide variety of regulatory bodies as the scope of the impact such a merger has globally is astronomical. The Competition Commission is involved as it is responsible to ensure free trade practices. The SEBI intervenes as it is the security regulatory body in India, and it lays down guidelines for this type of combination. All sanctions are received through the National Company Law Tribunal, and it is at liberty to recommend changes, approve or deny the scheme of the merger in order to facilitate the smooth functioning of the merged entity.

Keywords: *Cross-Border Mergers, National Company Law Tribunal, Competition Commission of India.*

I. INTRODUCTION

A cross-border merger is when two companies located in separate geographies merge to create one legal entity. This can be beneficial for the companies as it aids in expansion. In India, cross-border Mergers are regulated by Section 234 of the Companies Act, 2013. It lays down the conditions for these mergers as follows:

- The companies need the prior approval of the Reserve Bank of India (RBI).
- The new entity must submit a valuation on the basis of universally accepted principles of

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accounting to the RBI.

- The provisions from Section 230 to 240 of the Companies Act, that regulate mergers in India also apply to these mergers. This includes seeking approval form the NCLT, SEBI, creditors, and shareholders.
- Provisions need to be made for the shareholders of the merging entity in terms of the financial pay-out from the amalgamation.

The regulations make it feasible and facilitate cross-border mergers and help the economy of the country in terms of foreign investment as well as creation of jobs and a lack of regulations dissuade foreign companies from investing in India. As Foreign Investment is involved in these transactions, Section 47 of FEMA,[2] The RBI guidelines for the mergers and amalgamations must be followed by the Indian and foreign company. The effect that these transactions have on the market in India makes it liable to follow the regulations laid down by the competition Commission.

The SEBI is involved as the mergers and acquisitions sometimes happen by way of purchase of shares of the target company by the acquiring company. this requires all involved parties to follow the guidelines laid down by SEBI in order to allow legal transfer of shares. It also protects both companies from fraud by curbing manipulation. The NCLT plays a vital role in approving the merger at every step of the way and hence all summons and orders made by the tribunal must be complied with.

II. LAWS GOVERNING CROSS-BORDER MERGERS IN INDIA

(A) Section 234 of Companies Act, 2013

The Sections from 230 to 234 of the Companies Act, 2013, apply to mergers between companies in different jurisdictions. These sections establish regulations for the various compliance and procedural aspects of an amalgamation. The following are provisions of the sections:

- The Companies need the prior approval of the RBI in order to merge.
- The scheme of the merger must contain provisions to pay considerations to the shareholders of the resulting company.

(B) Rule 25A Companies Rules, 2016

The provisions of this rule ensure that the merging companies seek the approval of the RBI as

[2] Section 47 of the Foreign Exchange Management Act, 1999

well as adhere to the Rules prescribed by the Companies Act, 2013 as follows:

1. Section 230, Companies Act, 2013

The section provides for an application to be filed with the NCLT pertaining to the arrangement of restructuring. The application must include all material facts of significance in the application to the tribunal.

2. Section 231, Companies Act, 2013

The tribunal responsible for sanctioning the scheme of the company has the right to monitor and supervise the execution of the scheme. The tribunal must also consider the rights of the employees and cannot sanction any scheme that calls for waiver of the worker compensation. The tribunal can also reject any scheme where the permit was obtained by way of fraud. The tribunal also has the right to modify the scheme, they cannot completely change the nature of provisions but must provide suggestions while keeping the nature of the arrangements intact.

3. Section 232, Companies Act, 2013

This section provides for reconstruction which allows for parts of the business entity are transferred to a new company. It also provides for an amalgamation when two entities merge to form a third entity it constitutes an amalgamation. These forms of reconstruction and amalgamation can be achieved by means of the shares being sold, the sale of the business, by way of dissolution.

4. Section 233, Companies Act, 2013

This section allows for the merging of small companies and subsidiary companies. The approval of the registrar as well as the tribunal is required with reference the scheme proposed by the companies.

(C) Foreign Exchange Management Regulations, 2018

This act is responsible for the regulations with relation to the foreign exchange in the country. With relation to cross-border mergers, the regulations ensure that a check is kept on the management of the company. Some of the regulations to be followed by merging companies are as follows:

- All transactions undertaken to facilitate a cross-border merger must be ratified by the RBI.
- The valuation of the merging companies must be carried out in accordance with the requirements in Rule 25A of the Companies Merger Rules.
- The merging companies are required to report all transactions undertaken to facilitate a

cross-border merger as required by the RBI.

- The Managing Director is required to file a certificate along with the application to NCLT, stating that all the FEMA guidelines are being complied with.

(D) International Organisation for Securities Commission (IOSCO)

The IOSCO is an organisation responsible for safeguarding the financial interest of the business entities in different geographies in order to promote and protect trade. India is a signing member of this organisation. The requirement by this organisation is that any business entity in another country must sign a memorandum of understanding with the Stock Exchange Board of India (SEBI). In an attempt to put a stop to money laundering and other financial frauds, the IOSCO by way of a Multilateral Memorandum of Understanding which sets international standards for cross-border mergers between signatory countries. It allows for the collaboration and safe transmission of information between the companies. The following aspects that need to be complied by companies are as follows:

- The procedure of information to be exchanged.
- The type of information to be exchanged.
- The legal capacity to compel companies to reveal information.
- The prescribed use of this information.

The IOSCO established a task force that assisted the regulatory bodies of signatory countries in order to address the roadblocks in the existing process of mergers and take steps to mitigate these. The disclosure regulations of different countries vary and hence the IOSCO has standardised set of rules. The following are the regulations[3]:

1. Financial Data

The companies must provide the necessary financial data of the past five years in order to determine a pattern and make a more accurate estimation of their financial health. The reports must be pertaining to the foreign standards of accounting. This must include the values of the net sales of the companies, income gained from operations, net assets, capital stock, net income. Details of the exchange rate must be mentioned as the currency used in both financial reports might vary. It should also contain an audit report which contains the Balance sheet, cashflow and income statement.

[3] International Disclosure Standards For Cross-Border Offerings and Initial Listings by Foreign Issuers, International Organization of Securities Commissions, September 1998.

2. Risk Analysis

Both companies must include details about the risk with reference to risks existing in the industry as well as the company. this can relate to the nature of the business, specific risk factors pertaining to the countries.

3. Details of the business

This section contains the details of the businesses pertaining to the various segments of operation as well as details of the products or services offered by the companies. It should also contain the details of the new products being developed and their status. It must also include details of the raw materials and details about the prices of the raw materials pertaining to their volatility. It should also contain the method of sales opted for. It should include all the licenses and patents owned by the company and all contractual obligations they entered. It should include the manufacturing procedure opted for by the company. it should also include any subsidiaries owned by the company and their details. They should mention the tangible assets owned by the companies and details of the properties as well as details pertaining to the ownership or lease agreements. It should also contain details of the board of directors and the share ownership of the company. It must contain details of any ongoing legal or arbitral proceedings.

(E) Regulations of the Competition Commission of India (CCI)

Mergers and Acquisitions can cause the resultant company to have a significant part of the market share, and this jeopardizes the right to fairly practice trade that other competitors have. Section 32 of the Competition Act[4] states that it is applicable in any transactions that may result in the abuse of dominant position or mergers and acquisitions. With reference to cross-border mergers the first consideration is the examination of the transaction. Section 5 of the Competition Act, 2002[5], sets the threshold in an acquisition, the target company in a cross-border mergers that have assets of INR 2000 Crore or a turnover of INR 6000 Crore.[6] Section 6 of the Competition Act[7] states that any combination that can have adverse effects on the market then it is void.

This gives the Competition Commission the power to regulate these amalgamations as well as protect the consumers as any type of monopoly can adversely impact them.[8] Merging entities

[4] Section 32 of the Competition Act, 2002.
[5] Section 5 of the Competition Act, 2002.
[6] Notification No. S.O. 675(E) dated March 2016.
[7] Section 6 of the Competition Act, 2002.
[8] Section 18 of the Competition Act, 2002.

must notify the Competition Commission of India and seek approval. The notice must be sent to the CCI within the period of 30 days from the following:

- The board of directors of the companies approving the scheme of merger.
- The execution of any agreement in pursuance of the combination.

The CCI also has the right to carry out an investigation and employ various determining factors to make the decision. The two factors that determine if a merger must come under the review of the CCI are as follows:

- If the merger will cause dominance in the market and subsequently cause the prices to rise.[9]
- If the merger can cause collusion between the other companies in the market as a result to the merger.

No merger can be materialised unless a period of two hundred and ten days have passed after the notice is served to the CCI or the date of the passing of an order by the commission in approval, rejection, or modification of the merger. After a year from the date of the materialisation of the merger, the CCI is not allowed to intervene in the functioning of the merged entity.

(F) Regulations of the Securities and Exchange Board of India (SEBI)

SEBI regulates the acquisitions of companies that are listed on the stock exchange. This is done when the acquiring company a substantial number of shares or voting rights in the transferee company. The purpose of these guidelines is to promote transparency in the takeover procedure. They also ensure that competing offers from multiple companies are handled with due procedure. They also ensure that all the information that needs to be disclosed by both target and acquiring company is complied with. The takeover guidelines[10] require the acquirer company to make an open offer if they already hold 26 % shares of the transferee company before acquiring any additional shares. SEBI presides over this process to protect the rights of the shareholders from being infringed. The following guidelines must be followed by companies:

1. Open Announcement

SEBI requires the acquiring company to make a public announcement when they acquire the voting rights or shares in the target company and cross the threshold of 26% voting rights or

[9] Simon Bishop & Mike Walker, The Economics of EC Competition Law 260 (2 ed. 2002).

[10] 3(2) Securities and Exchange Board of India Regulations, 2011.

shares.

2. Obligations of Disclosure

The guiding principle behind asking the companies to disclose these activities is due to the fact that the shareholders don't participate in certain affairs of the company and hence need to be kept informed as these transactions will have an impact on them. The acquiring company is obligated to disclose purchases of stock of the target company within a period of two days from the allotment of said stocks. The target company is also expected to follow disclosure protocol during this period and must attain approval from their shareholders before carrying out certain transactions. The types of offers determine the regulations that need to be followed and differ as follows:

3. Mandatory Tender Offer

This is a requirement placed on the acquiring company that necessitates that when they attain 26% of the shares of the target company, they must mandatorily make an open tender offer to the shareholders of the target entity.

4. Voluntary Tender Offer

The takeover regulations allow current and new investors to acquire shares in a company. In order to make a voluntary offer, certain conditions are to be met. The acquiring company will not be allowed to acquire any new shares for a 6-month period post completion of said offer.

5. Competing Offer

This type of offer must be made within a 15-day period from the date of the original offer. Time is of the essence in such a situation and the target company must treat both offers at par and extend all information as necessary to both companies. The target company can't favour one offer over the other and cannot act in a manner that displays bias. When one competing offer gets picked over the other, the company that loses isn't permitted to sell the shares to the final acquiring company.

These regulations are applicable in the following circumstances:

1. The target company is a listed entity.
2. The acquirer is a foreign listed company, and the target company is of Indian origin.
3. The acquirer is a listed Company of Indian origin, and the target company is a foreign entity.

III. INBOUND MERGER

An Inbound merger is when the merger between a foreign and Indian Company results in an Indian entity. The conditions laid down in terms of Inbound mergers are as follows:

- Any activity relating to the issuing or transfer of shares must be done under the Foreign Exchange Management Regulations, 2000.
- All borrowings from foreign entities must be in conformance to the regulations formulated by the RBI.
- The transfer and holding of assets outside India must be in accordance with the Foreign Exchange Management Act, 1999.

The various aspects of an Inbound Merger are as follows:

(A) Securities

A Transfer of securities occurs when the holder of these securities, voluntarily transfers them through a contract. After a cross-border merger, the resultant company can transfer securities to a person or company, both inside and outside India as per the Foreign Exchange Management Regulations, 2017.

(B) Borrowing

Any borrowings of the merging companies become the borrowings of the resultant company. The RBI has laid down guidelines for these types of borrowings from foreign entities under the External Commercial Borrowings Regime. Companies that merged with foreign entities are given a period of 2 years in order to comply with all the requirements of the External Commercial Borrowings.

(C) Assets

The companies Act, 2013, lays down regulations to be followed by companies when dealing with assets and their subsequent transfer. The resulting companies are also required to comply with these rules. Any assets the resulting company is not authorised to own must be disposed of within a period of 2 years from the date of the National Company Law Tribunal (NCLT) sanction.

(D) Offshore office

The office of the foreign company becomes the offshore office of the resulting company and must follow the rules laid down by the Foreign Exchange Management Act (FEMA) in this respect.

IV. OUTBOUND MERGER

An Outbound Merger is when an Indian company merges with a foreign company results in a foreign firm. The following are the conditions to be met by the resultant entity:

- Any Indian resident holding any entity or company abroad must comply with the Provisions of the Liberalized Remittance Scheme or Foreign Exchange Management Regulations, 2000, as applicable.
- All borrowings must be repaid by the resultant company under sanctions by the National Company Law Tribunal (NCLT).
- Within permissible limits, such assets can be held, acquired, or transferred under the FEMA guidelines.

The following are the aspects of outbound merger:

(A) Securities

The resulting company is a foreign entity and can transfer securities globally to persons and entities. The Reserve Bank of India (RBI) has formulated regulations called Overseas Direct Investment (ODI) and controls investment that occurs outside India. The resulting company needs to adhere to these regulations. The valuation of the securities must be in accordance with 9Bthe specifications laid down under Liberalised Remittance Scheme of the RBI.

(B) Onshore office

The Indian office of the merging companies becomes the branch office of the resulting company and the rules laid down by the Foreign Exchange Management Act, 1999 (FEMA) must be adhered.

(C) Assets

The resulting company is permitted to purchase and subsequently transfer assets in India in accordance with the Foreign Exchange Management Act (FEMA). In the event that the ownership of such property is not permitted by FEMA, the company has a period of two years to dispose of said property.

(D) Borrowings

In the case of a merger, these borrowings become that of the resulting company and must be repaid in accordance with the NCLT scheme of amalgamation for this purpose as long as it is in accordance with the Foreign Exchange Management Act (FEMA).

V. Regulations vis-à-vis valuation

The valuation of the target company is one of the most essential steps in the merger as it determines if the merger will be profitable. A preliminary valuation is done on the asset base of the target company which is an analysis of all the asset holdings of the entity. This is done by subtracting the liabilities from the assets. This method of valuation is also used to gauge the overall health and performance of the company. Section 247 of the Companies Act, 2013, aims to standardise the valuation procedure in India and bring it up to the standard of international requirements as well as regulate the procedure and lay down requirements for the valuation as well as the valuers. It states that, when a valuation is required for any assets, liabilities, stocks, securities, debentures, goodwill, or the net worth of said company, it must be carried out by a professional with the qualifications and registration with a recognised organisation. The following is expected from the valuer:

- The report of valuation of the assets and liabilities must be fair and impartial.
- They must carry out a complete due diligence while valuing the company.
- The valuation must follow the prescribed standards and regulations.
- They shouldn't value any vested interest in the assets he is valuing as it is a conflict of interest.
- They should be of sound mind and a citizen of India and having attained majority and a resident of India.
- Rule 18 of The Companies (Registered Valuers and Valuation) Rules, 2017, states that the Central Government modifies the standards of valuation, and the valuer must comply with these standards of valuation.
- The standards being complied with must be accepted by the registered organisation and compatible with international standards.
- The report made by the valuer must contain the purpose of the valuation as well as the types of investigations undertaken to decipher the value of the assets as well as the sources and nature of the information relied on. It must also contain their conclusion and any disclaimer they wish to convey.

VI. Role of NCLT

The Companies Act, 2013 gives the National Company Law Tribunal has the jurisdiction of High Courts in order to sanction mergers and acquisitions between any Indian entity and hence during the process of a cross-border merger, the merging entities have to apply to the NCLT for approval. This ensures that a standard procedure is established, and all deals are carried out fairly and without bias. In the case of S.P. Sampath Kumar v. Union of India[11], the Supreme Court held that as per the recommendations of the Shah Committee[12], there is need for a separate Administrative Tribunal in order to reduce the burden of the judiciary and equip the legal system to tackle the complex issues that arise due to the changing scenario.

(A) Drafting of the scheme

The scheme is the deal made between the merging entities and is included in the scheme and must be approved by the NCLT along with any modifications they recommend. It contains all the clauses required to engineer a merger in order to lay down binding regulations and rules that the companies need to operate. It also contains details of the companies as well as the prayer or relief sought. The sections are as follows:

- The introductory section contains the Incorporation date, Corporate Identification Number (CIN), objectives mentioned in the MOA and AOA.
- The operating section contains the transfer of the undertaking, details of transfer of assets, existing debts and liabilities, licenses owned by the company, details about employees and staff, details about the issuing and allotment of shares.
- Prayer or relief section containing the approvals and proof of the bank draft that evidences the payment of the application fee.

(B) Call for board meeting

The companies need to send an application to the NCLT by filing form No. NCLT 1 and the approval received by the companies in form No. NCLT 2, affidavit of form No. 6 and a copy of the scheme of the amalgamation as well as the fee mentioned in the schedule of fees. It must also contain the auditor report, details of any legal procedure and additional details of the corporate debt restructuring if it exists. The NCLT may accept this application and give directions for the meeting with the creditors or other members.[13] The notice for said meeting is then sent to all concerned members and creditors. They must also be sent a copy of the scheme.[14] The scheme needs to be approved by creditors and shareholders for the process to begin as they are impacted by the financial decisions made by the company. the company

[11] S.P. Sampath Kumar v. Union of India, 1986 JT 1 996.

[12] Government of India, Law Commission of India, Report No. 272, Assessment of Statutory Frameworks of Tribunals in India, October 2017.

[13] Rule 5, Compromise Arrangement and Amalgamation, 2016.

[14] Rule 6, Compromise, Arrangements and Amalgamations, 2016.

additionally needs to put out a notice in one English newspaper and one regional newspaper. Form CAA-3 states that the notice, scheme of amalgamation needs to be sent to the central government, Income Tax department, Registrar of Companies, RBI, and the Competition Commission of India as the transition will have an impact on all the areas that these regulators operate in. In the event that these agencies have recommendations for the company, the same is to be communicated to the NCLT within a period of 30 days from the date they received this communication.

(C) Appointment of chairman

The NCLT appoints a chairman, and they are required to file with the tribunal an affidavit, seven days prior to the meeting, attesting that all the directions in terms of the notices and advertisements to be issued have been complied with. The meeting then proceeds to approve all aspects of the scheme. Voting must be conducted in order to show the assent of the members, this can either be achieved in person or via ballot. The scheme is considered approved when three- fourths of the member's assent. The chairman must then submit Form No. CAA- 4 within three days from completion of the meeting, in compliance with the procedure laid down.

(D) Sanction of scheme

The company, within seven days of the merger must submit a petition to the NCLT through Form No. CAA-5, requesting the sanction of the scheme. The notice of said hearing must be printed in the same newspapers, as the advertisement of the meeting was aired within a period of 10 days.[15] The order of the tribunal shall be served to the respective members under Section 230 (4). The NCLT is at liberty to sanction the scheme. In the event of the scheme being sanction, they may suggestions with regards to modifications to be made in the scheme. These modifications are made in order to allow for smooth functioning of the merged entity. The order is notified via Form No. CAA-6 and a copy that has been certified is required to be filed at the registrar of Companies with INC-28 that informs the registrar of the order of the NCLT. This needs to be completed within a period of 30 days of the receipt of the order.

VII. Conclusion

Cross-border mergers have become the quintessential tools for market expansion as it allows companies to foray into new geographies and markets with ease. They help revive companies and create jobs as well as help the economy flourish. The regulations in order to achieve this combination are essential as they protect both the companies and aid in due diligence which is

[15] Rule 16, Compromise Arrangement and Amalgamation, 2016.

an essential step as some companies might window dress and paint a positive picture of their financial health when that is far from the case. this is avoided by way of robust disclosure requirements imposed on both the entities.

A challenge for countries to enable cross-border mergers is in terms of regulations. If the compliance required is too cumbersome, it might dissuade foreign entities from merging with Indian entities. In India several regulatory bodies are involved in the sanction of cross-border mergers in order to prevent fraud and promote smooth functioning of the merged entity. The rules applicable to this combination are found in the Companies Act, 2013. The companies intending to merge, need to carry out transactions in accordance with the guidelines laid down in the act as well as that mentioned by the SEBI as they regulate the securities market in India. The companies must also follow all requirements of the RBI as foreign investment is involved.

These mergers come under the purview of the Competition Commission of India as they can adversely impact the market by attaining a market share that is too big and hence impacts other players. The CCI ensure that the market is functioning freely as a monopolised market impacts the consumers. The CCI has set a threshold for filing of mergers, as combinations falling below that limit don’t have the capacity to adversely impact the market. The NCLT plays a big role in the sanction of mergers and regulates it by approving all the steps of the procedure in the interest of ensuring the companies don’t carry out fraudulent activity and disclose all the required information to the shareholders who might be kept in the dark about certain transactions which might impact them financially. The assent of the shareholders is important for a merger to be successful and hence it is of utmost importance that they be kept informed.

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