Legal Issues in Acquisition

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Kinds of Acquisitions

**Acquisitions**

- Friendly takeover
  - Negotiated takeovers
  - Sale through bidding

- Hostile takeover
  - Not a negotiated acquisition

  - Indian Hotels (Tata group) $1.8-billion bid for Orient Express
  - Jupiter Metal’s bid for Kalindee Rail
  - No such term in Indian Takeover Regulations but is permitted
  - Hurdles to hostile takeovers – Not popular in India

- Leveraged buyouts
  - Acquisition funded through borrowed funds

  - Apollo’s acquisition of Cooper Tire

- Bailout takeovers / Bankruptcy
  - Generally a profit
  - Making entity acquires a loss making entity
Kinds of Acquisitions

**Joint Ventures**

- Collaboration of two or more entities for a specific venture
  - Tata-Pepsi joint venture for Mineral Water Business
  - Tata-Starbucks joint venture for coffee chains in India
  - Tata-Air Asia joint venture

**Demergers / spin off / spin out**

- Splitting of entity into two or more entities

**Assets and Business transfers / Slump Sale**

- Acquisition of specific identified assets or business unit / division as a whole on a going concern basis
Key Laws / Policies

**Private M&A**

Slump Sale / Merger / Demerger / Amalgamation / Share Sale/ Assets Sale

**Public M&A**

Takeover through open offers / hostile takeover / Block and Bulk Deals (large shares deals)/ Delisting and Minority Squeeze out

The applicable laws depend upon the nature of M&A deal

Different kinds of acquisitions attract different laws
Key Laws / Policies

Broadly, the applicable laws are:

- Corporate Laws
- Contract Law – important to govern the contractual agreements
- Foreign exchange regulations / FDI Policy *(applicable in cross border M & A)*
- Securities Law – Takeover Code / Insider Trading / Listing Agreement / ICDR Regulations / SCRA *(applicable in cases of Public M & A)*
- Anti-Trust laws (i.e. Competition laws and regulations)
- Taxation – Both direct and indirect taxes (e.g. transfer taxes, capital gains, withholding taxes, etc.) including tax treaties *(applicable in cross border M & A)* and potential tax liability post acquisition, tax indemnities
Key Laws / Policies

- Stamp duty – both Central Levy and State (local levy)
- Employment Laws
- Sector Specific Laws including local laws
- Environment Laws
- Anti Corruption Laws – Prevention of Corruption Act, 1988
- Judicial Precedents and Regulators’ Orders
Structuring an Acquisition

- Objectives to be achieved

- Structuring depends on the nature of acquisition – Share Acquisition Vs. Business Acquisition Vs. Assets Acquisition Vs. Other Forms of acquisition

- Nature of the target company – private, public, listed, unlisted, presence of minority and existing shareholders, etc. and their rights – how to structure the new investment

- Level of acquisition
  
  Minority (<50% - popular limits 26%, 49%)
  Majority (>50% - popular limits 51%, 74%, 76%)
  Equal (50 % :50 %)

- Nature of the instruments used – equity, preference, convertible securities, warrants

- Board and management rights in subsidiaries

- Decisions regarding subsequent funding

- Dividend Policy
Structuring an Acquisition

- Rights and restriction in Shareholders’ Agreement
- Transfer of shares issues – detailed and lengthy negotiations!

  Rights such as ROFR/ROFO, Tag along rights, Drag Along rights, lock in period, restriction on sale to a competitor/mandatory transfer provisions/change of control

- Management, Board Rights and Control Issues
  - Caution to be exercised to ensure it does not result into change of control unless specifically intended
  - Change of control issues in contracts and licenses

- Reserved Matters/Veto Rights/Affirmative Votes
  - Are they enforceable?
  - Do they result in giving control?

- Amendment of articles of association is a must to be enforceable against the company – Recent case of Delhi High in World Phone’s case
Structuring an Acquisition

- Is it a debt funding or equity funding?
- Resolution of Deadlock – 50:50 Joint Venture – One option is buyout auction
- Clarity whether Investor / acquirer to be classified as promoter or not
- Issuance of Promoter and Corporate Guarantees
- Acquisition of operation control - generally till the approval of scheme of amalgamation is obtained
- Check for exemptions under statutes such as Takeover Code (Regulation 10), Competition law (Schedule I, Assets and Turnover Criteria), contract law and structure to fit within the exemptions
- Directors’ and Officers’ Insurance Policy
- Governing Law and Arbitration Provision
  - Seat/Venue of arbitration
  - Check for Reciprocating Territories
Acquisition by Slump Sale

- Clear definition of “Undertaking” and “substantially the whole of the undertaking” (s. 180 (1) (a))
  - “Undertaking” means an undertaking in which the investment of the company exceeds 20% of its net worth as per preceding financial year’s audited balance sheet or which generates 20% of the total income of the company during the previous financial year
  - “Substantially the whole of the undertaking” means 20% or more of the value of the undertaking as per the audited balance sheet of the preceding financial year
- Applicable to private companies as well
- Board’s approval followed by shareholders approval by special resolution by postal ballot
- Whether holding of “shares or securities” constitute an “undertaking”? 
Private vs. Public – Is it worth the debate?

Various exemptions for private companies withdrawn

- Shareholders to approve preferential allotment of shares & convertible debentures / securities (s. 62 and s.71)

- Sale, lease or disposal of undertaking and borrowing above certain limits needs a special resolution (s. 180) (*Exemption proposed in draft notification of MCA*)

- Granting of loans, security or guarantees by private companies curbed (s.185 and s. 186) (*Exemption from Section 185 proposed in draft notification of MCA*)

- Making investments above certain threshold needs shareholder nod (s. 186)

- Directors cannot vote on any ‘interested arrangements/contracts’ (earlier only public companies) (s. 184 (2))

- DVRs exemption withdrawn (s. 43(a)(ii)) (*Exemption proposed in draft notification of MCA*)

- Voting right compulsory (Exemption under s. 90 of 1956 Act withdrawn) (*Exemption proposed in draft notification of MCA*)

- Subsidiary of public company is public irrespective of AOA (s. 2(71) proviso)
Then why a private company – Are any exemptions left now?

- Restriction on transferability of shares – although not material any more in view of section 58 (2)
- Two members to form quorum of shareholders’ meeting
- Two directors are required (as against 3 in case of a public company)
- May provide additional grounds of disqualifications for directors in its articles of association
- Additional grounds for vacation of directors in its articles of association
- No requirement to keep the contract of employment with MD and WTD at its registered office
- Can provide financial assistance to persons for the purchase of its own shares by giving loans for such purchases
- No retirement of directors by rotation
- No restriction on the limits of managerial remuneration
- Postal ballots
- Voting by electronic means at general meetings
Then why a private company – Are any exemptions left now?

- Exemption regarding disclosure in board of directors’ report of formal annual evaluation of board’s own performance and that of its committee and individual directors
- Appointment of Woman Director and Independent Directors
- Appointment of Audit committee and Nomination and Remuneration Committee
- 2 directors on CSR committee with exemption to have independent directors on CSR committee
- Appointment of KMP
- Vigil Mechanism (but applies to private companies with borrowings from banks and financial institution exceeding Rs. 50 Crores)
- Internal auditor (but applies to private companies with turnover of Rs. 200 crores or more during the preceding financial year or outstanding borrowings from banks and financial institution exceeding Rs. 100 Crores at any point during the preceding financial year)
Are you my subsidiary?

- Test of subsidiary is exercise or control of > 50% of the **total share capital** instead of > 50% equity share capital (s. 2(87))

- So an investor holding CCPs of a greater amount than equity shareholders may become the holding company of its portfolio entity?

- PE investors not registered as companies under 2013 Act also covered?

- 50% test can be satisfied directly or together with other subsidiaries (s. 2(87))

- Holding of CCDs does not trigger the provision
What makes you a promoter?

- **“Promoter”** includes a person that: (s. 2(69))
  - has direct or indirect control over the affairs of the company
  - as a shareholder, director or otherwise

- **“Control”** includes (s. 2(27))
  - Right to appoint majority of the directors
  - Right 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
  - But does not apply for the test of subsidiary – subsidiary’s test still on controlling the composition of the Board of Directors
  - There is mix up of the concept of control – At some places 2013 Act says control as per the SEBI regulations
What makes you a promoter?

Will veto rights make an investor or investor director a promoter?

Subhkam Ventures (SAT) says NO

- SEBI’s position: the definition of “control” would include veto rights since such negative control would effectively control the management and policy decisions of a company.

- Differing from the SEBI’s position, Securities Appellate Tribunal (SAT) in order dated January 15, 2010 held: “control” meant positive control, that is, the ability to cause a company to perform certain actions, and that it did not cover rights constituting “negative control”, i.e. the right to prevent the company from doing certain actions. The SEBI had appealed the aforesaid decision of SAT before the Supreme Court.

- Both SEBI and Subhkam Ventures reached an out of court settlement in the matter and the Supreme Court passed an order disposing off the appeal. The Supreme Court’s order dated November 16, 2011 accepting the out of court settlement between SEBI and the respondents, specifically states that the question of law (i.e., whether negative control is control) remains open and that the SAT decision would not be treated as precedent. This observation has far reaching ramifications.

Multi Screen Media (CCI) says YES
Promoters’ liability includes:

- Breach of private placement norms (s.42(10))

- Personally liable for fraudulent misstatement in prospectus (s.35)

- Exit option where objects of public issue varied without special resolution (s.13(8) and s.27)
Sample Veto Rights which may not trigger control

- amendment of charter documents (including change of name)
- increase or decrease of share capital
- acquisition or disposal of material assets
- amalgamation and merger of the company or demerger, share exchange, equity transfer, business transfer or business acquisition, or dissolution or any other transaction of similar nature
- approval of financial statements and dividend distribution
- material change in operation
- change in business plan
I've got the power

Before this goes too far, you really need some stake-holder input!
Increased power to more than 25% shareholding

- Several matters now need a special resolution of shareholders – this may reduce debates on veto rights where investors hold more than 25%:
  - Sale, lease or disposal of undertaking (s. 180(1)(a))
  - Investment of compensation received in a merger/amalgamation (s. 180(1)(b))
  - Borrowings exceeding paid-up capital & free reserves (excl. temp loans) (s. 180(1)(c))
  - Remitting or giving time for repayment of director's dues (s. 180(1)(d))
  - Certain related party transactions (s.188(1))
  - Amendment of entrenched provisions in AOA (s.5(3))
  - Preferential offers and issue of ESOPs (s. 62(1)(b) and (c))
  - If rights affected due to variation of rights of other class (s. 48(1) Proviso)
  - Issue of convertible debentures (s.71) or non-convertible debentures
  - Removal of auditors (s.140)
  - Expanding board size beyond 15 (s.149(1))
  - Reappointment of independent director after term of up to 5 consecutive years (s.149(10))
Special Care in Public M&As

A. Shares or voting rights acquisition

**Acquisition less than 25%** (only certain disclosures to be made at 5% and thereafter at every change of 2% or more)

- No Trigger (×)

**Acquisition of 25% or more** (also yearly disclosure to be made as of March 31 within 7 days)

- Triggers (✓)

**Additional acquisition** when the acquirer already holds between 25% and 75%

- Upto 5% in a financial year
  - No Trigger (×)
- More than 5% in a financial year
  - Triggers (✓)

B. Acquisition of control

Acquisition of control irrespective of acquisition or holding of shares or voting rights

- Triggers (✓)

C. Indirect acquisition of shares or control

- Triggers (✓)

- Be prepared for making the Public Announcement and Detailed Public Statement

- Compliances with Block and Bulk Deals requirements
Special Care in Public M&As

- Enforceability of call and put options
- Immediate delisting upon acquisition not permitted – waiting period of 12 months
- Look for exemptions in Takeover Code and structure to fit within the exemptions
- Compliance of SEBI / Stock Exchanges circular in scheme of amalgamation / arrangement
- Ensure not to disseminate unpublished price sensitive information – not applicable to communication required in ordinary course of business or profession or employment or under law
- Execution of Confidentiality Agreements/ NDA with the acquirer
- Standstill provisions to be incorporated
- Potential acquirer to ensure that information is kept confidential and does not deal in securities even if the deal is aborted until the information is made public
- Disclosures to be made under the SEBI Insider Trading Regulations, 1992 and new SEBI Insider Trading Regulations, 2015 (with effect from May 15, 2015)
Other Issues

- Applicability of Section 186 of Companies Act, 2013

- Applicability of Section 179 (3) (e) of the Companies Act, 2013 - to invest the funds of the company

- Restriction under Section 67(2) of the Companies Act, 2013 to public companies to give loan, guarantee, or provide security or otherwise, give any financial assistance for the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company

- Fresh issue of shares does not trigger related party transaction under Section 188 of Companies Act, 2013 but transfer of shares to a related party does trigger Section 188

- Converting the physical shares into demat shares before acquisition to save the cost of stamp duty

- Ensure that the share certificate or DP statement showing the acquired shares is taken on the closing date and all relevant forms are filed and the statutory registers are updated to reflect the issue / transfer of shares to the acquirer
Forward Dealing

- Section 194
- All kinds of companies covered
- Prohibition on whole-time directors and KMPs
- Prohibition on buying in the company, its holding, subsidiary or associate company, a right to call / the right to elect to call for delivery or a right to make delivery at a specified price and within a specified time, of a specified number of relevant shares or a specified amount of relevant debentures
- Punishment for contravention – Imprisonment for 2 years or with fine from Rs. 1 lac to Rs. 5 lacs or both
- Director and KMP liable to surrender the securities so acquired and company should not record the transfer
- Does it affect ESOPs issued to directors and KMPs?
- Does it affect call and put options?
Insider Trading

- Section 195
- All kinds of companies covered
- Prohibition on any person including directors & KMPs
- Does not apply to any communication in the ordinary course of business or profession or employment or under any law
- Insider trading includes – act of subscribing, buying, selling securities or entering into an agreement to do the above if the person is reasonably expected to have access to non-public price sensitive information (NPSI)
- NPSI means any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of the company
- No clear exemption for unlisted companies including private companies – confusion all over – Case of swimming without water!
- Does not prescribe mode or manner of publication of NPSI
- Does this impact secondary sales and investments?
- Penalty is Rs. 5 lac to 25 crore or 3 times the amount of profits made
Other Key Challenges

- **Preparing the Target for Sale** - generally in bidding process sale
- **Legal Issues**
  - Complexity and uncertainty of legal provisions - divergent legal views
  - Enforcement of contracts
  - Environment laws: Different standards and compliance levels
  - Dispute resolution: Speed, process and efficacy
- **Financing acquisition** – Difficulties in arranging finances
- **Political and Regulatory** – Political and regulatory uncertainties
- **Post Acquisition Difficulties**
  - Ensuring top-line growth
  - Delivering synergies
  - Employee retention
  - Avoiding disruptions
  - Systems / People / Cultural integration
  - Termination of existing contracts, if required
- **Hidden dangers** – Undisclosed Liabilities or Understated Liabilities
- **Environmental Issues** – Meeting the norms of environmental compliances
- **New Contracts**
- **Replacement of parent company guarantees and other commitments**
Reps, Warranties & Indemnities

- Who represents and warrants – company or promoter or both?
- Whether absolute or qualified – best knowledge qualifiers
- Limitation: different levels – e.g., tax liabilities 7 or more years
- Enforceability of liquidated damages - In India liquidated damages becomes a cap - penal damages will not be enforced
- Threshold for invoking indemnity claims- individual and aggregate thresholds
- Cap on indemnity liability
- Use of escrow by acquirer to recover indemnity claims
Non-compete / Non-Solicitation

• Usual to insert a non-compete but enforcement specific or otherwise a big question mark – though Indian law different from usual common law rule of “reasonable restriction” acceptability

• Section 27 of Contract Act renders “void” a non-compete restrictions except in case of “sale of a business” with goodwill and that too with specific limitations on duration, scope and geographic extent

• Selling Shareholders cannot be prevented from undertaking employment in a competing business

• Confidentiality obligations are enforceable
Thank You

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