

# Laws Regulating Mergers And Acquisition In India

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A merger is a combination of two companies where one corporation is completely absorbed by another corporation. The less important company loses its identity and becomes part of the more important corporation, which retains its identity. It may involve absorption or consolidation.

Merger is also defined as amalgamation. Merger is the fusion of two or more existing companies. All assets, liabilities and the stock of one company stand transferred to Transferee Company in consideration of payment in the form of:

- (i) Equity shares in the transferee company,
- (ii) Debentures in the transferee company,
- (iii) Cash, or
- (iv) A mix of the above mode

## Motives Behind Mergers Of The Company

- (i) Economies of Scale: This generally refers to a method in which the average cost per unit is decreased through increased production.
- (ii) Increased revenue /Increased Market Share: This motive assumes that the company will be absorbing the major competitor and thus increase its to set prices.
- (iii) Cross selling: For example, a bank buying a stock broker could then sell its banking products to the stock brokers customers, while the broker can sign up the bank' customers for brokerage account.
- (iv) Corporate Synergy: Better use of complimentary resources. It may take the form of revenue enhancement and cost savings.
- (v) Taxes: A profitable can buy a loss maker to use the target's tax right off i.e. wherein a sick company is bought by giants.

(vi) Geographical or other diversification: This is designed to smooth the earning results of a company, which over the long term smoothens the stock price of the company giving conservative investors more confidence in investing in the company. However, this does not always deliver value to shareholders.

## Types Of Mergers

*From the perception of business organizations, there is a whole host of different mergers. However, from an economist point of view i.e. based on the relationship between the two merging companies, mergers are classified into following:*

(1) Horizontal merger- Two companies that are in direct competition and share the same product lines and markets i.e. it results in the consolidation of firms that are direct rivals. E.g. Exxon and Mobil, Ford and Volvo, Volkswagen and Rolls Royce and Lamborghini

(2) Vertical merger- A customer and company or a supplier and company i.e. merger of firms that have actual or potential buyer-seller relationship eg. Ford- Bendix

(3) Conglomerate merger- generally a merger between companies which do not have any common business areas or no common relationship of any kind. Consolidated firm may sell related products or share marketing and distribution channels or production processes.

On a general analysis, it can be concluded that Horizontal mergers eliminate sellers and hence reshape the market structure i.e. they have direct impact on seller concentration whereas vertical and conglomerate mergers do not affect market structures e.g. the seller concentration directly. They do not have anticompetitive consequences.

The circumstances and reasons for every merger are different and these circumstances impact the way the deal is dealt, approached, managed and executed. However, the success of mergers depends on how well the deal makers can integrate two companies while maintaining day-to-day operations. Each deal has its own flips which are influenced by various extraneous factors such as human capital component and the leadership. Much of it depends on the company's leadership and the ability to retain people who are key to company's on going success. It is important, that both the parties should be clear in their mind as to the motive of such acquisition i.e. there should be a sound idiom.

Profits, intellectual property, customer base are peripheral or central to the acquiring company, the motive will determine the risk profile of such M&A. Generally before the onset of any deal, due diligence is conducted so as to gauge the risks involved, the quantum of assets and liabilities that are acquired etc.

## Laws Regulating Merger

Following are the laws that regulate the merger of the company:-

### **(I) The Companies Act , 1956**

Section 390 to 395 of Companies Act, 1956 deal with arrangements, amalgamations, mergers and the procedure to be followed for getting the arrangement, compromise or the scheme of amalgamation approved. Though, section 391 deals with the issue of compromise or arrangement which is different from the issue of amalgamation as deal with under section 394, as section 394 too refers to the procedure under section 391 etc., all the section are to be seen together while understanding the procedure of getting the scheme of amalgamation approved. Again, it is true that while the procedure to be followed in case of amalgamation of two companies is wider than the scheme of compromise or arrangement though there exist substantial overlapping.

*The procedure to be followed while getting the scheme of amalgamation and the important points, are as follows:-*

(1) Any company, creditors of the company, class of them, members or the class of members can file an application under section 391 seeking sanction of any scheme of compromise or arrangement. However, by its very nature it can be understood that the scheme of amalgamation is normally presented by the company. While filing an application either under section 391 or section 394, the applicant is supposed to disclose all material particulars in accordance with the provisions of the Act.

(2) Upon satisfying that the scheme is prima facie workable and fair, the Tribunal order for the meeting of the members, class of members, creditors or the class of creditors. Rather, passing an order calling for meeting, if the requirements of holding meetings with class of shareholders or the members, are specifically dealt with in the order calling meeting, then, there won't be any subsequent litigation. The scope of conduct of meeting with such class of members or the shareholders is wider in case of amalgamation than where a scheme of compromise or arrangement is sought for under section 391

(3) The scheme must get approved by the majority of the stake holders viz., the members, class of members, creditors or such class of creditors. The scope of conduct of meeting with the members, class of members, creditors or such class of creditors will be restrictive some what in an application seeking compromise or arrangement.

(4) There should be due notice disclosing all material particulars and annexing the copy of the scheme as the case may be while calling the meeting.

(5) In a case where amalgamation of two companies is sought for, before approving the

scheme of amalgamation, a report is to be received from the registrar of companies that the approval of scheme will not prejudice the interests of the shareholders.

(6) The Central Government is also required to file its report in an application seeking approval of compromise, arrangement or the amalgamation as the case may be under section 394A.

(7) After complying with all the requirements, if the scheme is approved, then, the certified copy of the order is to be filed with the concerned authorities.

## **(II) The Competition Act ,2002**

Following provisions of the Competition Act, 2002 deals with mergers of the company:-

(1) Section 5 of the Competition Act, 2002 deals with “Combinations” which defines combination by reference to assets and turnover

(a) exclusively in India and

(b) in India and outside India.

For example, an Indian company with turnover of Rs. 3000 crores cannot acquire another Indian company without prior notification and approval of the Competition Commission. On the other hand, a foreign company with turnover outside India of more than USD 1.5 billion (or in excess of Rs. 4500 crores) may acquire a company in India with sales just short of Rs. 1500 crores without any notification to (or approval of) the Competition Commission being required.

(2) Section 6 of the Competition Act, 2002 states that, no person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void. All types of intra-group combinations, mergers, demergers, reorganizations and other similar transactions should be specifically exempted from the notification procedure and appropriate clauses should be incorporated in sub-regulation 5(2) of the Regulations. These transactions do not have any competitive impact on the market for assessment under the Competition Act, Section 6.

## **(III) Foreign Exchange Management Act,1999**

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 out of India) Regulation, 2000 issued by RBI vide GSR no. 406(E) dated 3rd May, 2000. These regulations provide general guidelines on issuance of shares or securities by an Indian entity to a person residing outside India or recording in its books any transfer

of security from or to such person. RBI has issued detailed guidelines on foreign investment in India vide "Foreign Direct Investment Scheme" contained in Schedule 1 of said regulation.

#### **(IV) SEBI Takeover Code 1994**

SEBI Takeover Regulations permit consolidation of shares or voting rights beyond 15% up to 55%, provided the acquirer does not acquire more than 5% of shares or voting rights of the target company in any financial year. [Regulation 11(1) of the SEBI Takeover Regulations] However, acquisition of shares or voting rights beyond 26% would apparently attract the notification procedure under the Act. It should be clarified that notification to CCI will not be required for consolidation of shares or voting rights permitted under the SEBI Takeover Regulations. Similarly the acquirer who has already acquired control of a company (say a listed company), after adhering to all requirements of SEBI Takeover Regulations and also the Act, should be exempted from the Act for further acquisition of shares or voting rights in the same company.

#### **(V) The Indian Income Tax Act (ITA), 1961**

Merger has not been defined under the ITA but has been covered under the term 'amalgamation' as defined in section 2(1B) of the Act. To encourage restructuring, merger and demerger has been given a special treatment in the Income-tax Act since the beginning. The Finance Act, 1999 clarified many issues relating to Business Reorganizations thereby facilitating and making business restructuring tax neutral. As per Finance Minister this has been done to accelerate internal liberalization. Certain provisions applicable to mergers/demergers are as under: Definition of Amalgamation/Merger — Section 2(1B). Amalgamation means merger of either one or more companies with another company or merger of two or more companies to form one company in such a manner that:

(1) All the properties and liabilities of the transferor company/companies become the properties and liabilities of Transferee Company.

(2) Shareholders holding not less than 75% of the value of shares in the transferor company (other than shares which are held by, or by a nominee for, the transferee company or its subsidiaries) become shareholders of the transferee company.

*The following provisions would be applicable to merger only if the conditions laid down in section 2(1B) relating to merger are fulfilled:*

(1) Taxability in the hands of Transferee Company — Section 47(vi) & section 47  
(a) The transfer of shares by the shareholders of the transferor company in lieu of shares of the transferee company on merger is not regarded as transfer and hence gains arising from

the same are not chargeable to tax in the hands of the shareholders of the transferee company. [Section 47(vii)]

(b) In case of merger, cost of acquisition of shares of the transferee company, which were acquired in pursuant to merger will be the cost incurred for acquiring the shares of the transferor company. [Section 49(2)]

#### **(VI) Mandatory permission by the courts**

Any scheme for mergers has to be sanctioned by the courts of the country. The company act provides that the high court of the respective states where the transferor and the transferee companies have their respective registered offices have the necessary jurisdiction to direct the winding up or regulate the merger of the companies registered in or outside India.

The high courts can also supervise any arrangements or modifications in the arrangements after having sanctioned the scheme of mergers as per the section 392 of the Company Act. Thereafter the courts would issue the necessary sanctions for the scheme of mergers after dealing with the application for the merger if they are convinced that the impending merger is “fair and reasonable”.

The courts also have a certain limit to their powers to exercise their jurisdiction which have essentially evolved from their own rulings. For example, the courts will not allow the merger to come through the intervention of the courts, if the same can be effected through some other provisions of the Companies Act; further, the courts cannot allow for the merger to proceed if there was something that the parties themselves could not agree to; also, if the merger, if allowed, would be in contravention of certain conditions laid down by the law, such a merger also cannot be permitted. The courts have no special jurisdiction with regard to the issuance of writs to entertain an appeal over a matter that is otherwise “final, conclusive and binding” as per the section 391 of the Company act.

#### **(VII) Stamp duty**

Stamp act varies from state to State. As per Bombay Stamp Act, conveyance includes an order in respect of amalgamation; by which property is transferred to or vested in any other person. As per this Act, rate of stamp duty is 10 per cent.

### **Intellectual Property Due Diligence In Mergers And Acquisitions**

The increased profile, frequency, and value of intellectual property related transactions have elevated the need for all legal and financial professionals and Intellectual Property (IP) owner to have thorough understanding of the assessment and the valuation of these assets, and their role in commercial transaction. A detailed assessment of intellectual

property asset is becoming an increasingly integrated part of commercial transaction. Due diligence is the process of investigating a party's ownership, right to use, and right to stop others from using the IP rights involved in sale or merger ---the nature of transaction and the rights being acquired will determine the extent and focus of the due diligence review.

Due Diligence in IP for valuation would help in building strategy, where in:-

(a) If Intellectual Property asset is underplayed the plans for maximization would be discussed.

(b) If the Trademark has been maximized to the point that it has lost its cachet in the market place, reclaiming may be considered.

(c) If mark is undergoing generalization and is becoming generic, reclaiming the mark from slipping to generic status would need to be considered.

(d) Certain events can devalue an Intellectual Property Asset, in the same way a fire can suddenly destroy a piece of real property. These sudden events in respect of IP could be adverse publicity or personal injury arising from a product. An essential part of the due diligence and valuation process accounts for the impact of product and company-related events on assets — management can use risk information revealed in the due diligence.

(e) Due diligence could highlight contingent risk which do not always arise from Intellectual Property law itself but may be significantly affected by product liability and contract law and other non Intellectual Property realms.

Therefore Intellectual Property due diligence and valuation can be correlated with the overall legal due diligence to provide an accurate conclusion regarding the asset present and future value

## **Legal Procedure For Bringing About Merger Of Companies**

### **(1) Examination of object clauses:**

The MOA of both the companies should be examined to check the power to amalgamate is available. Further, the object clause of the merging company should permit it to carry on the business of the merged company. If such clauses do not exist, necessary approvals of the share holders, board of directors, and company law board are required.

### **(2) Intimation to stock exchanges:**

The stock exchanges where merging and merged companies are listed should be informed about the merger proposal. From time to time, copies of all notices, resolutions, and orders

should be mailed to the concerned stock exchanges.

**(3) Approval of the draft merger proposal by the respective boards:**

The draft merger proposal should be approved by the respective BOD's. The board of each company should pass a resolution authorizing its directors/executives to pursue the matter further.

**(4) Application to high courts:**

Once the drafts of merger proposal is approved by the respective boards, each company should make an application to the high court of the state where its registered office is situated so that it can convene the meetings of share holders and creditors for passing the merger proposal.

**(5) Dispatch of notice to share holders and creditors:**

In order to convene the meetings of share holders and creditors, a notice and an explanatory statement of the meeting, as approved by the high court, should be dispatched by each company to its shareholders and creditors so that they get 21 days advance intimation. The notice of the meetings should also be published in two news papers.

**(6) Holding of meetings of share holders and creditors:**

A meeting of share holders should be held by each company for passing the scheme of mergers at least 75% of shareholders who vote either in person or by proxy must approve the scheme of merger. Same applies to creditors also.

**(7) Petition to High Court for confirmation and passing of HC orders:**

Once the mergers scheme is passed by the share holders and creditors, the companies involved in the merger should present a petition to the HC for confirming the scheme of merger. A notice about the same has to be published in 2 newspapers.

**(8) Filing the order with the registrar:**

Certified true copies of the high court order must be filed with the registrar of companies within the time limit specified by the court.

**(9) Transfer of assets and liabilities:**

After the final orders have been passed by both the HC's, all the assets and liabilities of the



merged company will have to be transferred to the merging company.

#### **(10) Issue of shares and debentures:**

The merging company, after fulfilling the provisions of the law, should issue shares and debentures of the merging company. The new shares and debentures so issued will then be listed on the stock exchange.

#### **Waiting Period In Merger**

International experience shows that 80-85% of mergers and acquisitions do not raise competitive concerns and are generally approved between 30-60 days. The rest tend to take longer time and, therefore, laws permit sufficient time for looking into complex cases. The International Competition Network, an association of global competition authorities, had recommended that the straight forward cases should be dealt with within six weeks and complex cases within six months.

The Indian competition law prescribes a maximum of 210 days for determination of combination, which includes mergers, amalgamations, acquisitions etc. This however should not be read as the minimum period of compulsory wait for parties who will notify the Competition Commission. In fact, the law clearly states that the compulsory wait period is either 210 days from the filing of the notice or the order of the Commission, whichever is earlier. In the event the Commission approves a proposed combination on the 30th day, it can take effect on the 31st day. The internal time limits within the overall gap of 210 days are proposed to be built in the regulations that the Commission will be drafting, so that the over whelming proportion of mergers would receive approval within a much shorter period.

The time lines prescribed under the Act and the Regulations do not take cognizance of the compliances to be observed under other statutory provisions like the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ('SEBI Takeover Regulations'). SEBI Takeover Regulations require the acquirer to complete all procedures relating to the public offer including payment of consideration to the shareholders who have accepted the offer, within 90 days from the date of public announcement. Similarly, mergers and amalgamations get completed generally in 3-4 months' time. Failure to make payments to the shareholders in the public offer within the time stipulated in the SEBI Takeover Regulations entails payment of interest by the acquirer at a rate as may be specified by SEBI. [Regulation 22(12) of the SEBI Takeover Regulations] It would therefore be essential that the maximum turnaround time for CCI should be reduced from 210 days to 90 days.

#### **Conclusion**

With the FDI policies becoming more liberalized, Mergers, Acquisitions and alliance talks

are heating up in India and are growing with an ever increasing cadence. They are no more limited to one particular type of business. The list of past and anticipated mergers covers every size and variety of business -- mergers are on the increase over the whole marketplace, providing platforms for the small companies being acquired by bigger ones. The basic reason behind mergers and acquisitions is that organizations merge and form a single entity to achieve economies of scale, widen their reach, acquire strategic skills, and gain competitive advantage. In simple terminology, mergers are considered as an important tool by companies for purpose of expanding their operation and increasing their profits, which in façade depends on the kind of companies being merged. Indian markets have witnessed burgeoning trend in mergers which may be due to business consolidation by large industrial houses, consolidation of business by multinationals operating in India, increasing competition against imports and acquisition activities. Therefore, it is ripe time for business houses and corporates to watch the Indian market, and grab the opportunity.

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