India

Negotiated M&A Guide

Corporate and M&A Law Committee

Contact

Jayesh H.

Juris Corp
Mumbai, India

jayesh.h@jclex.com

CHAPTER I

INTRODUCTION

Historically, the foreign investment policy of the Indian Government (during the period from 1950 to 1990) consisted of stringent foreign exchange controls and regulations (including in the form of industrial licensing, quota system, capital controls), a bar on free trade and control of the flow of funds to a very large extent. As early as 1984, India saw the failure of a takeover attempt of Escorts Limited and DCM by Swaraj Paul's Caparo Group, owing to the promoters using political clout against the uninvited acquirer.

However, 1991 witnessed a significant transformation and shift in the government policy with the introduction of the New Industrial Policy, 1991 which paved the way for economic liberalization in India. The government relaxed various controls and regulations allowing trade and commerce to flourish, resulting in a robust and progressive economy. It was then that India saw the emergence of new sectors such as information technology, telecom, and the rapid growth of service sectors like hospitality, banking, retail and entertainment. All of which led to the growth of the Indian financial system. Deregulation of industries coupled with participation from foreign investors marked the beginning of the era of large scale mergers and acquisitions (M&A) in India.

Since the year 2012, significant amendments were introduced in the Foreign Direct Investment Policy. FDI was increased from 51% to 100% (under the Approval Route) in Single-Brand Product Retail Trading and upto 51% (under the Approval Route) in Multi-Brand Retail Trading. Similarly, sensitive sectors like civil aviation (upto 49% under the Approval Route), insurance (upto 49% under the Automatic Route) and Defense (upto 49% under the Automatic Route and beyond under Approval Route) were liberalized, to increase the flow of foreign investments. To speed up the approval process, the Indian Government has now abolished the Foreign Investment Promotion Board (FIPB) and now approval will be granted by the concerned ministry.

The above led to notable deals such as Tesco-Tata, Etihad-Jet, AirAsia Berhad-Tata Sons in the M&A space. Similarly, with the central government's 'Make in India' pitch, the Defense Sector is expected to see some activity such as Lockheed Martin Corp's proposal to make India its global hub for manufacturing of F-16s. M&A is considered as the most favored route for FDI flows into India in the year 2017 as Indian entrepreneurs increasingly face capital shortage, such as e-commerce and telecommunications.

Outbound investments by Indian companies have grown manifold in diverse sectors ranging from oil & gas, steel, energy to telecommunications and pharmaceuticals. While this guide is not intended at enumerating figures on the M&A front, it would not be incorrect to say that India Inc. has, in fact, arrived.

The primary regulators governing M&A activity in India are the Securities and Exchange Board of India ("**SEBI**"), the Reserve Bank of India ("**RBI**"), and the Competition Commission of India ("**CCI**"). Although, it would be a rather herculean task to list all the laws dealing with M&A, the following is an indicative list of the legislation primarily governing M&A:

(a) The Companies Act, 2013 (the "**Act**"):

The Act is the statute primarily governing all matters relating to companies incorporated in India. Among other things, the Act specifically provides for the manner in which mergers, demergers, amalgamations and/or arrangements may take place pursuant to an Indian court sanctioned scheme. In August 2013, the old Companies Act of 1956 ("**Old Act**") was replaced by the Act. The Act not only amends major provisions of the Old Act but also introduces various new provisions regarding incorporation, management and operation of the companies in India. These new provisions have been introduced keeping in line with the ever evolving international practices.

In 2016, the provision of the Act dealing with amalgamation, compromise, arrangement, liquidation and winding up also got notified. Simultaneously, 'the National Company Law Tribunal' **("Tribunal")** also got constituted and replaced the erstwhile Company Law Board.

Subsequently, the Indian Government and the RBI notified provisions relating to cross-border mergers. In view of this, an inbound merger (merger of a foreign company into an Indian company with the Indian company as the resultant entity) as well as an outbound merger (merger of an Indian company into a foreign company with the foreign entity as the resulting entity) is now possible.

(b) Foreign Exchange Management Act, 1999 ("**FEMA**"):

FEMA and the various rules, regulations, circulars, etc. issued under FEMA consolidate the law relating to foreign exchange with the objective of facilitating external trade and payments and promoting the orderly development and maintenance of the foreign exchange market in India. The provisions of FEMA specify the current and capital account transactions which may be carried on with general or specific permission of the RBI and/or the respective departments of the Indian Government.

The two most relevant regulations under FEMA from an M&A perspective are:

(i) Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 ("**FDI Regulations**"):

The FDI Regulations and the press notes issued thereunder govern investments by persons resident outside India in shares, debentures (convertible and non convertible), security receipts and warrants of companies incorporated in India; in effect regulating inbound investments/acquisitions. In most sectors, 100% foreign direct investment is permitted (with or without conditions) without the prior approval of government. In certain sectors it is permitted only to the extent prescribed, subject to conditions set out in the sectoral policy, without the prior approval of Indian Government. Cross border mergers with certain foreign jurisdictions are now permitted.

(ii) Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 ("**Foreign Security Regulations**"):

Outbound investments by residents in India are regulated by the Foreign Security Regulations. Indian companies are permitted to invest up to 100% of their net worth in joint ventures or wholly owned subsidiaries abroad under the automatic route.

(c) SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ("**Takeover Code**"):

The Takeover Code, as the name suggests, regulates takeovers of (and substantial acquisitions in) listed companies in India. Any change in control of shareholding or consolidation of shareholding beyond certain thresholds requires an open offer to be made to the public. In addition to the above, the Takeover Code also specifies certain triggers which attract disclosure requirements including as regards share pledges.

(d) Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("**ICDR Regulations**"):

ICDR Regulations deal with the issue of further capital by companies that are listed or proposed to be listed on a recognized stock exchange in India. The ICDR Regulations *inter alia* regulate acquisitions that may take place by making preferential allotments. However, it is relevant to note that allotments which result in a change in control are required to comply with the provisions of the Takeover Code in addition to the provisions of the ICDR Regulations.

(e) Securities and Exchange Board of India (Delisting of Securities) Guidelines, 2003, ("**Delisting Guidelines**"):

Delisting Guidelines set out the procedure for permanent delisting of securities of a listed company from a stock exchange resulting in discontinuance of trading in such securities. Delisting can be (i) compulsory: where securities are permanently removed from the stock exchange at the behest of the stock exchange as a result of violation of compliance required by the stock exchange or upon the public shareholding in the company falling below the minimum level prescribed, or (ii) voluntary: where the promoters or acquirers desire to delisting shares from the stock exchange, with the intent of consolidating their shareholding or otherwise, subsequent to making a public announcement to that effect and providing an exit option to the existing shareholders.

(f) The Competition Act, 2002 (the "**Competition Act**"):

The Competition Act as amended by the Competition (Amendment) Act, 2007, *inter alia* provides for control over M&A activity and abuse of dominant position in the market. Prior approval of the Competition Commission of India ("**CCI**") is required for mergers and acquisitions above specified thresholds. The CCI has extra territorial jurisdiction as regards mergers or combinations taking place outside India as well.

(g) Insolvency and Bankruptcy Code, 2016

The Insolvency and Bankruptcy Code, 2016 (the "Code") is a landmark legislation which consolidates India's bankruptcy laws. While the Code does not directly deal with mergers & acquisitions, the insolvency process offers tremendous opportunity to potential acquirers to acquire assets of 'stressed companies'. What makes this route attractive is that it is (a) time bound, (b) insolvency process has been granted exemptions under most regulations (including the Takeover Code and the ICDR Regulations), and (c) past liabilities/actions can be whitewashed in the resolution plan approved by the Tribunal.

(h) Income Tax Act, 1961 (the "**Income Tax Act**") and indirect taxation:

(i) Any M&A transaction requires detailed evaluation of the tax consequences. The Income Tax Act governs all direct taxation within India and grants or withdraws certain benefits in the case of change of control/shareholdings subject to certain conditions. Under the present taxation system in India, taxes vary for each method of acquisition. For example, an asset transfer by way of slump sale may result in higher income for the seller and higher value added tax liability for the buyer, whereas M&A under the court scheme may result in additional benefits under the Income Tax Act and stamp duty laws when compared to an M&A by private arrangement. *[Ed. Note: A "slump" sale is defined under the Income Tax Act of India as a transfer for lump sum consideration without values being assigned to assets and liabilities (other than for the purpose of stamp duty). A transfer on a "going concern" basis. To be contrasted with an itemized sale of assets.]*

(ii) The development of jurisprudence on indirect transfer of assets in India had raised global concern. Section 9(1)(i) of the Income Tax Act, imposes tax based on business connection in India. It prescribes that all income arising, directly or indirectly, inter alia through transfer of capital asset situated in India is liable for tax. The jurisprudence have now evolved significantly, with the decision in the Vodafone case(which ruled that income accruing indirectly from transfer of capital asset is not taxable in India) and subsequent amendments to the Income Tax Act. Now, the shares (of an offshore company) would be deemed to be deriving substantial value from assets of its subsidiary situated in India if the (A) the value of the asset is more than INR 100 million; and (B) it represents at least 50% of the total value of assets globally owned by the company.

(i) Stamp duty:

The stamp duty payable on documents varies across different states as it is governed by the provisions of the Indian Stamp Act, 1899, or the legislations enacted by certain states, as the case may be. Stamp duty is a documentary impost and not a transaction tax. It is payable (i) prior to or at the time of execution of the document, or (ii) within three months of the executed document first being delivered and received in that part of India where either (x) anything under the document is to be done or performed, and/or (y) the property to which the document relates is situated.

CHAPTER II

STRUCTURE OF THE TRANSACTION

The terms 'merger' and/or 'amalgamation' have not been defined under the Act and are generally used interchangeably. In common parlance, merger is understood as the coming together of two entities resulting in the comingling of the assets, liabilities, rights and interests of such entities.

The term 'amalgamation' has been defined in the Income Tax Act. The definition of amalgamation in the Income Tax Act does not differentiate between a merger and an amalgamation and defines amalgamation as merger of one or more companies into another company or the merger of two or more companies to form one company such that, pursuant to the amalgamation, the assets and liabilities of the amalgamating company become the assets and liabilities of the amalgamated company and shareholders holding not less than three fourths in value of the amalgamating company become shareholders of the amalgamated company. The benefits of carried forward losses and unabsorbed depreciation of an amalgamating company are available only for certain types of companies falling within the scope of shipping, hotel, banking and industrial undertakings and further subject to continuity of the business for three years before the amalgamation and five years after the amalgamation. Further, stringent conditions are also applicable for closely held companies.

Types of restructuring

The two primary ways of restructuring a company are (i) organic restructuring, which refers to an internal change in the structure of the company without a change in the actual corporate entity undergoing the restructuring, and (ii) non organic restructuring, which involves the corporate entity being restructured, itself undergoing a change. As M&A largely falls within the non organic restructuring of a corporate entity, we shall be dealing with the most commonly used structures under the same:

(a) **Asset Purchase**

Asset purchase, as the name suggests, involves the sale and purchase of assets of a company wherein the transferee company buys assets of the transferor company. Parties are open to resort to buying and selling individual assets, including any plant and machinery, trademark/s or assign contracts, depending upon the nature of the asset. Typically a deed of conveyance will be executed for transfer of immovable property and for intellectual property a deed of assignment will be entered into. Each of these documents would contain all the usual covenants, applicable stamp duty would be payable and the documents would be required to be registered with the sub registrar of assurances or the trademark registry, as the case may be.

The Income Tax Act also recognizes transfer of an undertaking on a 'slump sale' basis and grants certain benefits to transfers where the transfer is for a lump sum consideration without assigning individual values to the assets and liabilities. An undertaking is defined to mean any unit or division or undertaking or a business activity taken as a whole. Although, assets and liabilities should not be assigned individual values under the asset transfer agreement, individual values would have to be determined for the purposes of payment of stamp duty, registration and other taxes. This requires a careful balancing act.

Mergers and amalgamations are generally time consuming and entail many compliances given that regulatory/statutory approvals or the sanction of the Tribunal may be required, thereby making asset transfers a preferred means of transfer in certain cases. Asset transfers are also carried out when a company possessing more than one business unit, or carrying on more than one business, decides to spin-off the business unit into a separate legal entity. Consideration of the sale of the undertaking is usually cash, though, use of fresh shares or debt instruments or any combination of the same is not uncommon. As a matter of prudence, the need to obtain consents from creditors, third parties or regulators should be evaluated. The transferee company may well be required, in some cases, to obtain statutory approvals or licenses for this purpose.

(b) **Schemes of Arrangement/Merger**

Sections 230 to 234 of the Act are a complete code in themselves, as regards corporate law, embodying the entire scope and procedure to be followed for Tribunal sanctioned mergers, amalgamations and arrangements. As a corollary, the Tribunal would not be allowed to usurp jurisdiction where it has none. For instance, the blessings of the Tribunal cannot substitute approval of the RBI, where required under the provisions of FEMA, or the FDI Regulations. The company itself, its members, its creditors (or class of creditors) or the liquidator (in case of a company in winding up) may make the application to the appropriate court.

When an application for the compromise or arrangement is made to the Tribunal by the company or of any creditor or member of the company or the liquidator (in case the company is being wound up), the Tribunal is required to order that a meeting of the creditors or class of creditors or of the members or class of members, as the case may be, ("Creditors and Members") be convened. There is no rigid formula for determining a class of creditors or members. It is the discretionary power of the Tribunal to determine these classes. Essentially, 'class' means persons whose rights are so similar that they can be combined together with a view to achieve a common interest. Generally, secured creditors and unsecured creditors could form distinct classes of creditors and members can be categorised into preference shareholders and common equity shareholders.

The notice of the proposed meeting is required to be sent to all Creditors and Members. Such notice is also required to be put on the website of the company and further is required to be sent to all the statutory authorities that may have jurisdiction on the company/ies forming part of the compromise or arrangement. Objections to the scheme of compromise or arrangement can only be made by persons holding a minimum of 10% of the shareholding or having an outstanding debt of 5% or more of the total outstanding debt as per the last audited financial statement. The scheme of compromise or arrangement is required to be passed by majority representing three-fourths in value of the creditors or class of creditors or members or class of members must be approved by a resolution passed by not less than three-fourths in value of the or members (or class of members), as the case may be, present and voting either in person or through proxies. Voting through postal ballot is also permitted.

Any person or group of persons holding 90 percent or more of the issued equity capital of a company can purchase the remaining equity shares of the company from minority shareholders at a price determined by a registered valuer subject to other applicable regulations. Alternatively, the minority shareholders of the company may also offer to the majority shareholders to sell the minority equity shareholding of the company at a price determined by a registered valuer.

Subsequent to the scheme being approved by the creditors and members, a petition for sanctioning of the scheme is filed the Tribunal. The approved arrangement is, unless prejudicial to public interest or interest of the creditors, sanctioned by the Tribunal and a certified copy of the order is required to be filed with the Registrar of Companies within 30 days of the receipt of the order.

Where the scheme of merger or amalgamation is between a listed transferor company and an unlisted transferee company, it is invariably provided that the transferor company will get delisted as per the provisions of the Delisting Guidelines and the transferee company will get listed and the shares of the listed transferee company, post merger, will be listed. This is pursuant to a discretionary exemption under securities laws. As a matter of prudence, a provision for delisting and listing should be incorporated in the scheme itself.

Although, the scheme is subject to the sanction of the Tribunal, it is deemed to have effect from the date specified in the scheme but will become effective only upon filing of the certified copy of the order of the high court with the Registrar of Companies. On sanction of the scheme by the Tribunal, it is binding on all the creditors, members as well as the company.

Cross Border Mergers

Cross Border mergers involve the merger of an entity incorporated in India with another entity incorporated outside India. Section 234 of the Act provides that a foreign body corporate or a branch of a foreign body corporate may merge with an Indian company. An Indian entity is permitted to merge with an entity incorporated in such foreign jurisdictions whose securities market regulator is a signatory to the Multilateral Memorandum of Understanding of the International Organization of Securities Commission or a signatory to the bilateral memorandum of understanding with SEBI; or a jurisdiction whose central bank is a member of the Bank for International Settlements; and a jurisdiction not identified in the public statement of Financial Action Task Force (FATF) as a jurisdiction having Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the FATF to address the deficiencies. All provisions provided above for mergers and amalgamation shall *mutatis mutandis* also apply to cross border mergers. It is pertinent to note that at the time of sanctioning the merger of a foreign transferor body corporate with an Indian transferee company, the Tribunal will consider the validity of the merger as per the laws of the country in which the foreign body corporate has been incorporated, prior to approval of the scheme of merger.

Though draft regulations regarding cross border mergers have been released by the RBI (the **"Draft Regulations"**), the final regulations are awaited. The Draft Regulations permit cross border mergers under the automatic route subject to satisfaction of certain conditions.

(c) Share Purchase

The most preferred way of acquiring a company is by purchase of its shares. When the acquisition is carried out with the intent to gain control over the company, the acquisition becomes a takeover. Acquisitions may be either friendly (when negotiated with the existing promoters of the target company) or hostile (when the management of the target company is not in favour of the acquisition). The acquisition of control may be through transfer of the existing shares and/or issue new shares to a person or group of persons.

(d) Leveraged Buyouts

In leveraged buyouts, a fund borrows (typically from a bank) to acquire another company. A leveraged buyout essentially is an acquisition of the assets of the company / the company itself by availing external financing (from banks / FIs etc.). Under recently released restructuring regulations by RBI (as well as under the Code), economic restructuring may be done by selling the majority stake in the borrower company to new promoters. Banks in India have generally not been permitted to lend for financing acquisition of companies by promoters as part of the promoter's contribution. However, an exemption has been made for specialized 'turnaround' entities (A 'specialized' entity is a body corporate set up for taking over and turning around troubled companies), which can avail financing to acquire stressed companies. As per the regulations, debt to equity ratio[1] for financing such an entity must not exceed 3:1. Also, Banks/FIs may receive cash/bonds/debentures as sale consideration for the stressed asset.

CHAPTER III

PRE AGREEMENT

Any type of M&A activity requires some ground work to be done before the parties decide to execute the transaction. Other than issues such as finding the right target company, business valuation etc., the parties generally undergo certain preparatory exercises such as signing of term-sheet/memorandum of understanding (MoU)/letter of intent and conducting due diligence. Signing of a term-sheet is the first step

[1] Debt to Equity ratio is used to measure a company's financial leverage, by dividing the company's total liabilities by its stockholders' equity.

towards materialization of the transaction. This pre-agreement document reflects the principal understanding between the parties and also provides the basis for the definitive agreement.

An MoU or a term sheet is a document incorporating the terms of the broad understanding between the parties without going into specifics. MoUs or term sheets are not always legally enforceable. A court in India will look at the substance over the form and determine the legal enforceability or effect of the document not by its nomenclature, but by its content. On the other hand, an MoU or a term sheet containing only very preliminary terms would not be binding, unless a binding understanding between the parties could be inferred from the context. Therefore, it is advantageous for the parties to draft the MoU or a term sheet in a manner and containing the exact intention of the parties, which will or will not make it legally enforceable.

The buyer may also press for a lock-up agreement with the major shareholders. Lock-up agreements generally prohibit the majority shareholders or promoters from directly or indirectly offering to sell or otherwise dispose of the shares they control during the lock-up period.

CHAPTER IV

ACQUISITION AGREEMENT

Generally, in the case of the purchase of shares, an agreement known as the 'Share Purchase Agreement' (SPA) is executed, whereas transfer of assets is done through 'Business Transfer Agreement' (BTA). While each agreement contains terms and conditions specific to issues at hand, the following would be the salient clauses of an acquisition agreement:

(a) **Holdback and Escrow**

Holdback involves the withholding of property or shares or purchase price until the occurrence of a specific event. Typical holdback provisions include a detailed description of the holdback (nature of the property or dollar amount of the holdback), the duration of the holdback and the events which will cause the holdback to be released. The usual conditions for the release of the holdback are: obtaining approvals/permissions from regulatory authorities and obtaining shareholder's consent for transfer. In several venture capital and private equity investments the conditions may be imposed until certain predetermined financial benchmarks are achieved. Holdback provisions need to be drafted with utmost clarity as several contingencies and eventualities will have to be evaluated and addressed during the course of the same.

Escrow essentially signifies putting in 'trust'. Creation of an escrow secures payment of money or delivery of property, as the case may be, on the occurrence of a certain specified events to the party entitled thereto. For instance, an escrow may be created in favour of the seller, for the holdback to be paid by the buyer, setting out the applicable release terms. This provides significant comfort to the buyer that the purchase price will be released only on fulfillment by the seller of its obligations/conditions precedent and ensures payment to the seller when due.

The escrow agent may be any independent third party. Attorneys and bankers (even if acting for one of the parties) do not usually act as escrow agents in India.

(b) **Representations and Warranties**

A significant feature of any agreement is the making of representations and warranties by the parties to each other. The seller's representations and warranties typically comprise the larger part of the agreement. Representations and warranties serve three important purposes. First, they are informational. The seller's representations and warranties, and the carve outs to the representations and warranties by way of a disclosure schedule coupled with the buyer's due diligence, enable the buyer to learn as much as possible about the seller's business prior to signing the definitive acquisition agreement. Second, they are protective. The representations made and warranties given by the seller provide a mechanism for the buyer to walk away from, or possibly to renegotiate the terms of, the acquisition, if the buyer discovers facts that are contrary to the representations and warranties between the signing and the closing of the transaction or even afterwards. Third, they are supportive. The seller's representations and warranties provide the framework for the seller's indemnification obligations to the buyer after the closing.

Common representations and warranties in an acquisition agreement include those relating to: (a) corporate organization, authority, capitalization; (b) ownership and good title to assets/shares; (c) nature of intangibles; (d) conducting business in accordance with the memorandum of association and articles of association; (e) existing financial indebtedness and security; (f) financial statements and other records; (g) payment of taxes; (h) contracts, leases, and other commitments; (i) share holding pattern; (j) employment matters; (k) compliance with laws and litigation; (l) no defaults under existing borrowings; (m) audited accounts; (n) solvency/ winding up; and (o) environmental compliance, if any.

While certain information provided by the sellers may be verified and relied upon in view of the filings made by the company at various public offices, reliance is required to be placed on the representations made by the parties where no such verification is possible. The Act requires filings to be made of any change in capital or a company's directors, any special resolutions passed, annual reports and creation of charges. Creation or modification of a charge must be registered within 120 days from the creation or modification thereof. Pledges of movables of an unlisted or private company are not required to be registered or to be disclosed under the provisions of any law in India. Therefore, it is not possible for the acquirer to verify unregistered charges or pledges that may have been created or guarantees that may have been provided, except by reliance on the representations made by the seller. Any agreement creating third party rights either in the nature of encumbrances or requiring prior consent of such third party would also not be publicly available, unless disclosed by the sellers. In case of an industry specific filing, as in the case of non banking financial companies, regulatory filings are not publicly available and cannot be independently verified. Similarly, the laws of India do not require that litigation against a company be registered with a public office.

Generally, representations and warranties are repeated at the closing of the transaction. The buyer has the right to terminate the agreement or to seek indemnification or both depending on the gravity of the breach of the representations and warranties. In the event a material adverse change occurs, the buyer has a vested right to terminate the agreement. This naturally makes the drafting of the material adverse very important.

Typical Qualifications to representations and warranties:

The sellers invariably qualify certain representations as being "to the best of their knowledge". Typically, the seller would warrant that to the best of its knowledge: (i) there are no covenants restrictions easements burdens stipulations or non-statutory outgoings affecting any freehold property; (ii) financial statements and accounts reflect the true state of affairs and the profits and losses of the seller adequately disclose all assets and liabilities of the business and policies of accounting which have been consistently applied in the accounts; (iii) there are no facts which are likely to give rise any litigation or arbitration or prosecution or other legal proceedings which would be material in the context of the financial or trading position of the business, etc.

Survival of the representation and warranties:

Generally speaking the representations and warranties will survive the termination of the agreement. Therefore, the acquirer would be entitled to claim indemnification on the basis of misrepresentation post closing. The law does not impose any limitation from seeking indemnification if the claim is raised within the prescribed period from the time the cause of action arose. However, the parties may contractually agree to limit the benefit of the representation on the insistence of the seller.

(c) **General Covenants**

These may be generally classified into negative and affirmative covenants. Negative covenants restrict the seller from taking certain actions prior to the closing without the buyer's prior consent. It protects the buyer as the seller is restricted from taking any actions prior to the closing that changes the business the buyer wishes to buy.

Typical negative covenants include: (a) not changing accounting methods or practices; (b) not entering into transactions or incurring liabilities outside the ordinary course of business or in excess of certain amounts; (c) not paying dividends or making other distributions to stockholders without prior consent of the acquirer; (d) not amending or terminating ‘material’ contracts; (e) not making capital expenditures beyond those budgeted, disclosed, etc.; (f) not transferring assets other than those contracted for and disclosed, etc.; (g) not creating any encumbrances on the assets/shares; (h) not releasing claims or waiving rights; (i) not doing anything that would make the seller’s representations and warranties untrue; and (j) not divulging confidential and sensitive information to third parties (except wherever necessary by law). Negative covenants may also include an undertaking that the sellers will not allow a change in the board of directors until closing of the transaction, unless relating to the appointment of directors nominated by the buyer.

Affirmative covenants obligate the seller or the buyer to take certain actions prior to the closing. Typical affirmative covenants include: (a) allowing the buyer full/restricted access to the seller’s books and records; (b) obtaining the necessary approvals from the board and the shareholders; (c) obtaining the necessary third party consents; and (d) obtaining the necessary statutory approvals.

(d) **Conditions Precedent**

Conditions precedent constitute an essential component of an agreement from the buyer’s perspective in so far as it protects the interests of the buyer by putting certain conditions on the seller. Conditions precedent vary from transaction to transaction depending on the facts and circumstances of each case. The most essential condition precedent would be providing clear and marketable title to the assets/shares of the target company.

(i) *Foreign investment permissions*: This is a determining factor in structuring any transaction under the Indian regulatory regime. In terms of foreign investment, permission of the RBI and/or Government may be required for investment in several sectors including insurance, banking, telecommunication, airlines, etc. given that India has not allowed full capital account convertibility and still maintains sectoral restrictions on foreign investment. Further, in the case of a company in the financial services sector, transfer from a resident to a non resident also requires prior permission.

(ii) *Regulatory approvals*: In addition to the permission of RBI and/or Government, permissions from various other ministries, government departments and local authorities also become an important factor. For instance, mergers and amalgamations of financial sector companies including banks, non banking financial companies, etc., require the prior permission of RBI as their sectoral regulator. Further, obtaining a certificate under Section 281 of the Income Tax Act confirming that there are no dues pending is recommended.

(iii) *Corporate authorization*: The Act permits the board of directors to take decisions for and on behalf of the company except those which specifically require prior authorization by the shareholders of the company. Certain shareholder approvals may be required.

(iv) *No Objection Certificates*: It is common for lenders and secured creditors to stipulate conditions in the loan agreements that require prior consent of such lenders to be obtained in case of any change in control and/or transfer of substantial assets of the debtor company. This ensures that no change in control that would be detrimental to their interests and security occurs without their knowledge and consent.

(v) *Due Diligence Results*: Prior to any merger or acquisition, the buyer is likely to carry out a due diligence review (which could be financial, accounting and/or legal) and any adverse finding found in the course of such due diligence process is generally sought to be removed/rectified prior to the closing of the transaction.

It is common practice to include the aforementioned provisions as condition precedent in addition to the seller covenanting the same to the buyer. This provides the buyer with an exit option in case of non fulfillment of the said conditions or at the very least leverage for renegotiation of the terms of acquisition.

Acquisition agreements provide that, as a condition to closing, the representations and warranties of the parties must be true and correct at the closing, and that the pre-closing covenants have been performed or fulfilled prior to the closing. This may be confirmed by each party delivering a written certificate to that effect to the other party.

(e) **Indemnification**

Indemnification provisions typically address misrepresentations, omissions and/or breaches of covenants or representations and warranties that are discovered subsequent to the execution of the agreement. The buyer and seller generally indemnify each other for all losses, claims, damages, costs and expenses incurred as a result of acts or misrepresentation or any breach, inaccuracy or incompleteness of any representation or warranty of the buyer and/or the seller set forth in the agreement or any other related documents.

Even on termination of the agreement and/or completion of the acquisition, the indemnification provisions survive and continue to protect the parties for any wrongs that may have been committed prior to the closing or termination.

(f) **Dispute Resolution**

The common approach adopted in devising a dispute resolution system is to agree on a neutral location for conducting arbitration to quell any inhibitions of parties of obtaining home advantage. The substantive law of the contract is predominantly Indian or English and occasionally that of New York.

One precaution that can be taken is to draft a clear arbitration agreement. The parties must clearly provide the place of arbitration, the substantive law governing the contract, the proper law of arbitration agreement, the procedural law governing the arbitration, the courts having exclusive jurisdiction (subject to arbitration), etc. In the case of international commercial arbitrations to be held outside India, two precautions that are required to be specially noted before drafting an arbitration agreement/clause are to specifically exclude application of Part I of Arbitration Act, 1996 and to give exclusive jurisdiction to a court in India only in relation to proceedings relating to the award.

*   *   *   *   *