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CORPORATE SYNERGIES: LEGAL PERSPECTIVES ON MERGERS AND ACQUISITIONS IN INDIA

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ABSTRACT

Corporate synergies in mergers and acquisitions (M&A) represent the potential financial and operational benefits gained through the combination of the companies. In the Indian context, these synergies are pivotal for companies striving to attain competitive advantages in a progressively globalized market. This paper explores the legal landscape surrounding M&A in Indian corporate context, focusing on potential synergies that drive corporate amalgamations and highlighting key considerations and legal perspectives that frame corporate consolidations. The study delves into the Companies Act, 2013, the Competition Act, 2002, SEBI Regulations and the M&A Act, 2022, while also analyzing the role of NCLT in facilitating and adjudicating M&A transactions and ensuring the adherence to statutory requirements. The findings underscore the importance of robust legal due diligence, strategic planning and regulatory compliance in navigating the complexities of M&A in India, ultimately contributing to the creation of value and sustainable growth for the combined entities.

Keywords: Corporate synergies, mergers and acquisitions, legal perspectives, due diligence, regulatory compliance.

CORPORATE SYNERGY

"Corporate Synergy" refers to the potential financial benefit that the corporations expect to gain through their congruent interaction with one another in the form of Mergers and Acquisitions (M&A). Literally translating to "combined value", the concept of Synergy states that combined value or performance of two firms congruently should be greater than the sum of separate values of individual firms. This means that if Company A is earning a profit of ₹20 crores and another Company B is earning a profit of ₹30 crores, then the net profit of both the companies after the merger should not be ₹50 crores but should be more than that for the merger to be successful.

This synergy often acts as a driving force behind a merger or acquisition. It can be gained through various means like increased revenues, combined talent and technology, and cost reduction.

Synergy can be categorized into two parts— Operational Synergy, which occurs when the merger or acquisition reduces the average cost of production of the firm(s); and Financial Synergy, which occurs when the merger or acquisition results in the reduction in the financial activities of the firm(s).

However, the synergy may not always lead to a successful result. It can sometimes result in negative synergy as well, which is caused when the net value of the combined entities antecede the sum of separate values of individual entities. It generally happens due to the reasons of different leadership styles and corporate cultures resulting in problems within the company. An evident example would be the Google and Motorola merger. In 2012, Google acquired Motorola for $12.5 billion in order to gain potential synergies by profiting from Motorola's patents and technology, the goal being able to produce high-quality Android-operated mobile handsets and re-rule in the smartphone domain.[1] However, the results weren't at par with Google's anticipations leading to the failure of the deal, largely because of unclear expectations and poor performance. Similar cases are Quaker Oats and Snapple deal, eBay and Skype merger, Microsoft and Nokia merger of 2014, Flipkart-Snapdeal merger, Cross-Border Apollo-Cooper Merger etc.

At the same time, we also have various instances of highly successful synergies, Facebook's acquisition of Instagram being a great example of financial synergy. Facebook acquired Instagram for $1 billion in 2012. At that time, Instagram was a newly launched start-up having less than 50 million users and revenue being negligent. The main reason behind this acquisition was that Facebook was growing old and was failing to attract young users. Moreover, it was lacking various features like stories, lives etc. which made Instagram a potential threat to Facebook, so rather than competing with it, Facebook bought it instead. As a result of this M&A synergy, Facebook benefitted from its fast-growing platform with millions of prospective customers, access to best developers and other technical specialists, and a chance to integrate the best photo-generating technology, while Instagram has grown exponentially since the merger as well[2], having over one billion users today and contributing over $20 billion to Facebook's annual revenue.

LEGAL FRAMEWORK OF M&A IN INDIA

Governed primarily by the Companies Act, 2013, along with the Companies Rules, 2016, the Indian regulatory environment for M&A comprises of a comprehensive set of laws and policies, including the Competition Act, 2000, Foreign Exchange Management Act, 1999, SEBI Regulations and Income Tax Act, 1961 as well. The latest development of M&A Act, 2022 has also significantly influenced and added to the legal framework of M&A in India.

[1] iDeals, Synergy Concept: Types of Synergies, reasons and examples, idealsvdr.com (last visited 31st May, 2024)

[2] iDeals, Synergy Concept: Types of Synergies, reasons and examples, idealsvdr.com (last visited 31st May, 2024)

A. COMPANIES ACT, 2013 [READ WITH COMPANIES (COMPROMISES, ARRANGEMENTSAND AMALGAMATIONS) RULES, 2016]

Chapter XV of Companies Act consisting of Section 230 to 240 deals with provisions related to M&A and the respective procedure.

Section 230 states the procedure for compromise or arrangements with creditors and members. It states that for such purpose, the applicant has to file an application with the National Company Law Tribunal (NCLT) along with consent of creditors, material facts and other disclosures. After the receipt of the application, NCLT will call upon a meeting whose notice will be served to all the creditors, members and debenture-holders and shall be published on the company's website and local newspaper. Notice shall also be served upon various authorities including Central Government, Income Tax Authorities, Reserve Bank of India (RBI) and Competition Commission of India (CCI) to attract any objections or suggestions within 30 days from them. Failing to reply within 30 days, it will be deemed as if the authorities have approved the arrangement. Where the company is a listed company, the notice shall also be served upon the Securities Exchange Board of India (SEBI) which will notify the same in its website. After the above procedure is fulfilled, a meeting shall be convened to approve the Resolution. Once approved, the scheme is filed with NCLT to get its final approval which shall be filed with the Registrar of Companies (ROC) within 30 days. **Section 231** provides the Tribunal the power to enforce and implement such compromise or arrangement.

Where the compromise or arrangement also includes M&A then in such case, along with the notice of the meeting as stated above, the draft scheme of M&A, report of impact of such M&A on the classes of shareholders, report of valuation etc. are also to be provided.[3]

Further, **Section 233** deals with the procedure related to fast-track mergers (merger between small companies, or a holding company with its wholly-owned subsidiary) and **Section 234** talks about the procedure related to cross-border mergers(merger with foreign companies).

Where the scheme to acquire the shares of the Transferor company is approved by the majority (90% or more) of the shareholders of such company, then after sending a notice to the shareholders dissenting from the scheme, the shares of those dissenting shareholders can be acquired by the Transferee company.[4] Similarly, where the acquiring company already holds 90% or more of the shares in the target company, then it may purchase the minority shareholdings of the company by paying such

[3] The Companies Act, 2013 (18 of 2013), Section 232, Acts of Parliament, 2013 (India).

[4] Id, Section 235.

shareholders within 60 days.[5] Regarding the offer of the scheme involving transfer of shares, minority or majority, the Transferee company has to first register such scheme or circular with the ROC before giving it to the shareholders.[6]

Moreover, the Central Government is also conferred with the power to provide for the amalgamation of the companies by notification in Official Gazette, if doing so is in public interest, and in case of any objections by the Transferor or Transferee company, any of them can file for the same with the NCLT which ten passes a final order after hearing such objections.[7]

Section 239 states that the books and papers of the amalgamated companies are to be preserved unless the permission to dispose them off is given by the Central Government after examining such documents. Further, **Section 240** of the Act provides that the liability of the officers in respect to offences committed prior to the merger or amalgamation shall continue even after such combination.

B. COMPETITION ACT, 2002

The Competition Act, 2002 contains comprehensive provisions regulating M&A in India. It facilitates competition and prevents anti-competitive practices in the market which cause Appreciable Adverse Effect on Competition (AAEC), i.e. restrict healthy competition, in the market.

Section 3 of the Act talks about two types of Anti-Competitive Agreements: Horizontal Agreements, which are the agreements between the direct competitors in the market (*for instance*, Ambuja and UltraTech Cement, Apollo Tyres and Ceat Tyres etc.), including bid-rigging or cartel formation agreements, whereas Vertical Agreements are the agreements between different participants of a value chain (*for instance*, agreement between a manufacturer and supplier, or supplier and distributer etc.). Horizontal Agreements are said to be of more heinous nature and are deemed anti-competitive by applying the *Rule of Per Se*. However, for Vertical Agreements, *Rule of Reason* is applied to determine whether such agreement is anti-competitive or not. Such agreements include tie-in arrangement, exclusive supply or distribution agreements, refusal to deal and resale price management and are only deemed anti-competitive if they are having AAEC in the market.[8]

The Act further states that where any entity holds a dominant position in the market and it abuses its dominant position by imposing unfair or discriminatory price or condition, limiting production or scientific development, denying market access in

[5] Id, Section 236.
[6] Id, Section 238.
[7] Id, Section 237.
[8] The Competition Act, 2002 (12 of 2003), Section 3(4), Acts of Parliament, 2002 (India).

any manner, implementing predatory pricing (to sell the goods at a price below the cost in order to eliminate competition), or by using power in one relevant market to enter into another relevant market, then it is included in anti-competitive practices.[9] *For example*, where BCCI being the sole regulator of Indian Premiere League (IPL) entering into an agreement to sanction, organize or recognize any league in India and denying market access to potential competitors of IPL, was held to be an abuse of dominant position by BCCI.[10]

Further, **Section 5** of the Act prohibits combinations that have, or likely to have, AAEC within the relevant market in India. **Section 6** provides for the regulation of combinations and establishes the Competition Commission of India (CCI) as the regulatory authority to scrutinize and approve combinations. The CCI has to approve or deny the combination within 90 working days and in the absence of any reply from CCI, the combination is deemed to have been approved.

The Competition Commission of India (Procedure in regard to the Transaction of Business relating to Combinations) Regulations, 2011, prescribe the form and content of the notice, containing the details of the combination and its impact on the competition, to be filed with CCI for notifying a combination, upon receipt of which the CCI examines the combination and approve the combination, either immediately or subject to certain modifications, if it is satisfied that the combination is not having AAEC on the market.

In contravention of the above provisions, the CCI is empowered to impose penalties, including penalty for implementing a combination without prior approval, where required. The CCI may also impose remedies to address competition concerns. *For instance*, a hefty penalty of ₹6700 crores was imposed on the Cement Companies in India where it was found that the cement companies had formed a cartel and were deliberately reducing the production of the cement collectively in order to cause an artificial scarcity of cement in the market so that they can charge high prices for the product.[11]

C. SEBI REGULATIONS

SEBI primarily regulates the securities market in India, while protecting the interests of the investors in securities and promoting the development of securities market in India.

[9] Id, Section 4.
[10] Surinder Singh Barmi v. Board for Control of Cricket in India (BCCI), [2013]118 SCL 226 (CCI).
[11] Builders Association of India v. Cement Manufacturers Association [2016] 73 taxmann.com 247 (CCI).

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 limits and inspects the acquisition of shares, voting rights and control in listed companies, requiring mandatory public officers in certain situations to protect minority shareholders.

SEBI (Listing Obligations and Disclose Requirements) Regulations, 2015 provides extensive scheme for administering a variety of listed companies, laying down below-mentioned conditions to be followed by such companies while filing an application to NCLT for approval of scheme of M&A:

a) Filing of a draft scheme with the stock exchange to receive its approval before filing the scheme and draft with NCLT.
b) Ensuring the compliance of the provisions of the applicable security law or request of stock exchange.
c) File any change in the pre and post shareholding pattern arrangement and the capital structure with the stock exchange.
d) Reveal all the price sensitive information and the information affecting the operations of the listed company pursuant to merger to the stock exchange.

SEBI (Prohibition of Insider Trading) Regulations, 2015 prohibits an insider from communicating unpublished price sensitive information (UPSI) or trading in securities when in ownership of UPSI, unless such communication is for legitimate purposes or in discharge of legal obligations.[12]

SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 apply when the acquisition of an Indian listed company entails the issue of new equity shares or securities convertible into equity shares by the issuer to the acquirer.[13] Also called ICDR Regulations, this regulation sets a floor price for issuance depending upon the highest and lowest closing weekly price of the company's stock during a period of 26 weeks, and locks-in the issued securities for a time period of one year from the date of trading approval.

D. INCOME TAX ACT, 1961

M&A attracts various tax benefits under this Act including exemption from capital gains tax arising from the transfer of capital assets[14] and set-off and carry forward of accumulated loss and unabsorbed depreciation of the amalgamating company in the hands of the amalgamated company[15], while also prescribing the conditions in which

[12] Aishwarya Shankar, All You Need to Know About Laws Governing Mergers and Acquisitions, iPleaders (last visited June 1, 2024), blog.ipleaders.in
[13] Id.
[14] Income Tax Act, 1961 (43 of 1961), Section 47, Acts of Parliament, 1961 (India).
[15] Id, Section 72A.

tax benefits as provided in **Section 80-IA** of the Act will continue as well as the conditions in which they won't be available[16].

E. FOREIGN EXCHANGE MANAGEMENT ACT, 1999 [READ WITH FOREIGN EXCHANGE MANAGEMENT (CROSS BORDER MERGER) REGULATIONS, 2018]

Abbreviately known as FEMA, the Act plays a crucial role in regulating cross-border transactions, which are integral to M&A activities involving foreign entities. The Act defines "inbound merger" as the merger in which the resultant entity of the combination of an Indian and a foreign company is situated in the home country (India), similarly, "outbound merger" is defined as the merger in which such resultant entity is in a foreign country. The Act further lays down the procedure for the M&A of an Indian and a foreign company, including obtaining the approval from the Central Government, compliance with valuation norms, reporting requirements and conditions laid down by RBI, and treatment of assets and liabilities and process of issuance of securities in such mergers. The Act also mandates the disclosure of details of foreign transactions and investments to RBI, while empowering the Central Government to make rules regarding such M&A, in consultation with RBI. It ensures adherence to all relevant FEMA regulations and internationally accepted pricing methodologies during the M&A process. Non-compliance of these provisions may also attract penalties, including fines and other punitive measures.

F. M&A ACT, 2022

Aiming to streamline procedures, enhance transparency and foster a more conducive environment for corporate restructuring, the Act marked a notable overhaul in the regulatory environment of Indian M&A.

Section 10 of the Act introduces a fast-track merger procedure, for small companies and start-ups, reducing the timeline and compliance burden, aiming to encourage entrepreneurial ventures by making it easier to restructure and consolidate.

Section 15 states that the companies are required to provide detailed disclosure about the impact of the proposed M&A, financial implications and reasoning behind the merger to the shareholders, creditors and regulatory authorities. Further, **Section 20** ensures that the minority shareholders receive equal treatment and fair consideration, hence reinforcing their rights.

[16] Id, Section 80-IA.

By enhancing scrutiny of cross-border M&A and mandating prior approval from government for strategic sectors, **Section 25** ensures that the national security or economic stability is not put at risk, hence aligning with the Foreign Exchange Management (Cross Border Merger) regulations, 2018 which makes the prior approval of RBI mandatory for cross-border mergers and empowers the Central Government to make rules regarding such M&As. Similarly, the Act mandates the prior approval of CCI for certain combinations, aiming to prevent anti-competitive practices and promote market fairness.

Moreover, **Section 35** of the Act provides for the hastened approvals for M&A involving tech start-ups and digital platforms, addressing and acknowledging the growing significance of digital economy.

Other than these legal requirements, the companies should also follow the procedure to devise a pre-transaction planning, determine the valuation of their assets and liabilities, ensure due diligence by vigilantly reviewing the target company's financial statements, legal documents and operational procedures, negotiating to establish a fair exchange ratio, obtain regulatory approvals and evaluate the success of the transaction while identifying the areas for improvement for the M&A to be fruitful.[17]

Non-compliance with these legal requirements may lead to delay in transaction, damage to company's reputation, rejection of the proposed M&A and even legal action and imposition of penalties upon the corporation. Hence, the entities must always ensure the compliance of the regulations in order to avoid any cumbersome consequences.

[17] Jay Bhavesh Parekh, Understanding Legalities – Mergers, Acquisitions and Combinations, ICSI (May, 2023), https://www.icsi.edu

CONCLUSION

The legal landscape for M&A in India is intricate and evolving, carved by an extensive regulatory framework aimed at ensuring a fair competition, transparency and protection of shareholders’ interests. The Companies Act, 2013, the Competition Act, 2002 and SEBI Regulations, alongside the adjudicative role of the NCLT, form the cornerstone of the regulatory environment governing M&A in India. Corporate synergies derived from these M&A activities offer remarkable opportunities for corporates to enhance their market position and operational efficiency. However, achieving these synergies necessitates meticulous legal due diligence, strategic foresight and adherence to statutory implications. The recent M&A Act, 2022 represents a significant advancement aiming at simplifying procedures, enhancing transparency, and providing vigorous protection to stakeholders. As India continues to harmonize into the global economy, a nuanced understanding of legal perspectives on M&A has become crucial for companies aiming to capitalize on growth opportunities while mitigating risks. Hence, its high time for the regulatory bodies to evolve in tandem with market dynamics to facilitate seamless and value-accretive M&A transactions.