UNDERSTANDING THE LEGAL ASPECT OF MERGERS AND ACQUISITIONS

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Dimple Aswani, Law Student, UPES, Dehradun

ABSTRACT

Over the past decade, mergers and acquisitions, or M&As, have emerged as the primary engine of the global economy and have influenced the business strategies of many companies. An increasing number of businesses are using mergers and acquisitions (M&A) as strategic growth tools to increase their market share, margins, and overall dominance, in addition to allowing them to remain competitive. It is amazing how quickly and on what scale merger activity is emerging. Over the past few decades, the majority of research has concentrated on comprehending the significance of engaging in mergers and acquisitions (M&A). The current study explains mergers and acquisitions in detail and the legal aspects governing them. Although the field of research with respect to this topic is vast, this paper aims to concisely summarise the important information in this regard.

Keywords: *Acquisitions, Dominance, Economy, Market Share and Mergers.*

1. INTRODUCTION

Mergers and acquisitions (M&As) are business transactions in which the ownership of companies is transferred or consolidated with another. An acquisition happens when one company purchases the assets or share capital of another, whereas a merger is the legal combination of two distinct companies into one. The difference between a merger and an acquisition is that a merger is the combining of two separate entities into one new entity, whereas an acquisition refers to the takeover of one entity by another. A merger is a more friendly deal and results in reducing the authority of each company separately. Typically, mergers are done to reduce operational costs, expand into new markets, boost revenue, and increase profits. An acquisition is comparatively more hostile where a smaller company ceases to exist and is taken over by a larger one. The larger company takes over all of the operational management decisions of another company. In this case, the buyer's power is absolute. The acquirer must purchase at least 51% of the target company's stock in order to gain absolute control over it. No new shares are issued in the case of an acquisition. Since practically mergers are not that common and acquisitions are considered to be hostile, one term is often taken to be the other. Current corporate restructurings are usually referred to as mergers and acquisitions rather than just mergers or acquisitions. Mergers and acquisitions help in the growth of market share or downsizing of companies, increase the overall performance efficiency of the companies, and also change the nature of business or their competitive position by eliminating potential competitors.

2. HISTORICAL BACKGROUND

Mergers and acquisitions find their roots in the historical time periods in India. The history of M&As can be divided into two phases: pre-liberalisation and post-liberalisation.

2.1 Pre- liberalization period: M&A activity accelerated during and after the Second World War due to changes in the political and economic landscape. During the war, there was an inflationary gap. Well-known industrial groups began buying up well-established businesses in order to gain control over the market. Nearing independence, British stakes in companies were sold to Indian companies. Restrictive trade practices resulted in many horizontal combinations and conglomerate combination[1]s. The government of the day promoted M&A by enacting new regulations in the banking and insurance sectors (1969), nationalising the Indian insurance business in 1959 (resulting in 243 insurance companies), and announcing new tax breaks for capital gains in the finance bill (1967). While horizontal mergers were discouraged, conglomerate mergers were encouraged by these changes. Prior to the 1990s, a stringent set of regulatory laws applied to domestic businesses. Corporate businesses grew sloppily as a result of this restrictive environment.

2.2 Post-liberalization period- Globalisation in 1990 resulted in the improvement of corporate governance. The common way of growth and expansion in the corporate world were mergers and acquisitions. Many acts and amendments came into place to govern M&As. The Indian economy witnessed a boom in mergers in almost every sector, like IT, electronics, oil and gas, and the banking industry[2]. This also resulted in a high standard of living and a growth in consumerism.

3. TYPES OF MERGERS

Horizontal merger: It is a merger between companies in the same industry. Industries with fewer firms tend to have higher levels of competition, which makes the synergies and potential gains in market share for merging firms much greater. For this reason, horizontal mergers are common in these industries. A merger of Coca-Cola and Pepsi, for instance, will be horizontal in nature. The main motive behind a horizontal merger is to create a new and expanded business with a greater market share. The business operations of Coca-Cola and Pepsi, being almost similar, might give opportunities to combine some of their processes, including manufacturing, and help save costs[3].

Vertical merger: When two or more firms that are operating at different levels of a supply chain in the industry merge operations, it is termed a vertical merger. The main goal of this is to make the combined company more efficient. A vertical merger would be the combination

[1] Raees Khan & Tina Vyas, *History of Mergers and Acquisitions in India: Past Activities and Future Possibilities*, 8(9) INT'L J. RSCH. SOCIAL SCI. (2018)
[2] *Id.*
[3] Manisha Paliwal, *Mergers and Acquisitions in India: A Trend Analysis and Future Forecasting*, SSRN ELEC. J. (2016)

of an automaker and a supplier of parts, for instance. A deal like this would give the car division more control over the manufacturing process and better pricing on parts.

Market extension mergers: This occurs between two businesses that sell the same goods in different marketplaces. Gaining access to a bigger market for the merging companies guarantees a larger customer base, which is the main goal of this type of merger. The purchase of RBC Centura and Eagle Bancshares Inc. is one instance of a market extension merger. With its headquarters located in Atlanta, Georgia, Eagle Bancshares has 283 employees. It oversees $1.1 billion in assets and about 90,000 accounts. One of the key benefits of the acquisition is that RBC can keep growing its business in the North American market. The important benefit of this merger is that RBC now has the chance to deal in Atlanta's financial market, which is one of the most promising emerging financial markets in the country. RBC would be able to diversify its operations with this move.

Product extension merger: The merger between two business entities operating in the same market and dealing in products that are related to each other is termed a product extension merger. The merging companies can combine what they offer and reach a larger consumer base through a product extension merger. This will increase their profit margin. A product extension merger is exemplified by Broadcom's acquisition of Mobilink Telecom Inc. Broadcom manufactures the hardware for IEEE 802.11b wireless LAN chips and Bluetooth personal area networks. Global System for Mobile Communications (GSM)-enabled handset product designs are manufactured by Mobilink Telecom Inc. The wireless products from Broadcom and Mobilink Telecom Inc. will work well together, benefiting both companies.

4. THE MERGER & ACQUISITION PROCESS

- Preliminary discussions and non-disclosure agreements: Before the transaction, both companies must evaluate their strengths and weaknesses and the fair value of their assets and liabilities. Before moving forward, a non-disclosure agreement must be executed so that the confidential information shared is not leaked for private gain[4].

[4] Naina Srivastava, *Merger and Acquisition in India*, 1(5) INT'L J. L. MGMT. & HUMAN. (2018)

- Assessment and evaluation of target: All the material risks that might arise in the sale process are to be identified and assessed. The target firm's contracts, legal documentation, operational procedures, and financial reports should all be thoroughly examined by the purchasing company.

- Due diligence within a data room- This is an important step in the process. Data rooms are online portals that allow companies, advisors, and potential bidders (together with their advisors) to see documents in a secure and safe manner from anywhere in the world. Using a virtual data room is the safest way for companies and deal teams manage deal documents and other important business data[5]. It enables buy-side teams to thoroughly and methodically review, investigate, and verify all of this information. Conducting, due diligence provides both the companies with an opportunity to resolve all the issues regarding the deal before moving forward.

- Exchanging documents and signing the contract: Once due diligence is conducted, the necessary legal documents, such as the merger or acquisition agreement, must be prepared. The approvals required by the board of directors, shareholders, and other stakeholders, such as government and regulatory bodies, will depend on the specifics of the deal. The final contract will be signed, and the funds will be exchanged.

- Post-deal integration: Full-scale integration of the purchased company can begin upon deal closing. This is the last step. As this step can be intensive, an integration plan should be prepared beforehand.

5. LEGAL ASPECTS WITH REGARD TO M&As

Due Diligence: In the process of due diligence, lawyers carefully assess a number of different elements, such as current contracts, regulatory compliance, intellectual property rights, current or upcoming legal disputes, employment-related issues, environmental concerns, and even instruments like legal invoice software that an organisation uses for legal billin[6]g. Their main goal is to identify and draw attention

[5] Manisha Paliwal, *supra* note 3
[6] Raees Khan & Tina Vyas, *supra* note 1

to any risks or liabilities that might affect the transaction, making sure that no detail is overlooked, and—most importantly—to raise any issues that could result in further legal action.

Deal structure: Whatever structure is being consented to in the agreement, it is imperative to take into account the pertinent legal concerns, such as shareholder permission, the tax implications of the structure, transferability of liability, requirements for third-party contractual consent, and foreign regulatory issues (if applicable). Another crucial choice is whether to acquire the entire business or simply its assets, assuming no liability.

Representations and warranties: Acquirers now include representations and terms of warranties in the contract. This is done to protect the purchasing company from any lawsuits, including tax compliance, capitalization, etc.

Non-competes and non-solicits: These are important legal clauses in the transactions. They are the acquirer's legal promise to not engage in any competitive business activity for the set time frame[7]. It is a legal insurance that protects intellectual property, etc.

Target indemnification: This gives another chance to the acquiring company to protect itself against contractual breaches from the target company. These terms outline which indemnity clause types result in the termination of the agreement and how the target company will repay the agreed-upon sum up to the closing price. In this clause, shareholders can be either jointly or severally liable. In the event of **several liability**, the shareholders will only be held accountable to the degree of their contribution to the damages, whereas in the event of joint liability, each shareholder of the target firm will be entirely liable for any future damages.

Closing conditions: Closing conditions are typically listed in a definitive agreement as a section that outlines all the requirements that must be fulfilled in order for the transaction to be closed. There are instances when the letter of intent contains a list of necessary closing conditions. Closing conditions typically include a list of

[7] Naina Srivastava, *supra* note 4

prerequisites, including shareholder and board approval, no significant changes to the target company's operations, and specific financial requirements.

6. LAWS REGULATING M&As

6.1 Companies Act 2013

India's legal framework governing M&As is primarily governed by the Companies Act of 2013. A merger, acquisition, or combination's procedure is mainly outlined in the Companies Act. It provides a legal framework for combinations, mergers, and acquisitions in India, which are frequently employed as corporate growth or restructuring strategies. The board of directors, shareholders, and regulatory bodies such as the Competition Commission of India (CCI), the Securities and Exchange Board of India (SEBI), and the National Company Law Tribunal (NCLT) must all give their approval. The Companies Act also dictates the rights of the workers, creditors, and shareholders of the combined companies. In general, India's laws pertaining to mergers, acquisitions, and combinations. The proposal must be approved by at least 75% of the shareholders present by voting. The Companies Act offers minority shareholders additional protection. The Companies Act mandates that minority shareholders' shares be treated equally with the shares of the majority shareholders. Shareholders in the minority have the ability to protest the merger or acquisition and to make inquiries for their shares' fair market value to be assessed by a separate appraiser. Sections 230–240 of the Companies Act, 2013 deal with mergers and acquisitions. Sections 230–232 talk about normal mergers and amalgamations; Section 233 deals with fast-track mergers; and Section 234 deals with mergers with foreign companies.

Section 230[8]: "*It lays down the procedure by which the company can enter into any compromise or arrangement between creditors and members*".

Section 232[9]: "*It talks about broad provisions governing mergers and amalgamations of companies and provides for compliances that shall be undertaken for mergers. The*

[8] Companies Act, 2013, § 230, No. 18, Acts of Parliament, 2013 (India)
[9] Companies Act, 2013, § 232, No. 18, Acts of Parliament, 2013 (India)

application for merger is to be filed with the National Company Law Tribunal in Form No. NCLT-1".

Section 233[10]: "*It provides for fast-track mergers. The following companies can adopt the fast-track merger route:*

1. *Two or more small companies*
2. *A holding company and its wholly-owned subsidiary company*
3. *Two or more start-up companies*
4. *One or more start-up companies with one or more small companies*

The notice for this is to be sent to the Registrar and Official Liquidators in Form No. CAA-9".

Section 234[11]: "*It talks about mergers and amalgamations of companies with foreign companies. A foreign company may merge with a company registered under this act or vice versa with the prior approval of the RBI*".

6.2 Competition Act 2002

Another important law in India that controls competition in the market is the Competition Act, 2002[12]. It does this by prohibiting anti-competitive agreements, abuses of dominance, and mergers and acquisitions that could negatively affect market competition. This Act controls mergers and acquisitions that could significantly reduce market competition. The Competition Commission of India (CCI) is the body that evaluates whether any proposed merger or acquisition has an adverse effect on competition. The CCI may or may not approve the merger or acquisition, subject to certain conditions given in the Act. The SCM Solifert Ltd. & ANR. v. Competition Commission of India case[13] is an instance where the CCI fined the company because it found their acquisition to be in non-compliance with the provisions of the Competition Act.

6.3 SEBI Regulations

[10] Companies Act, 2013, § 233, No. 18, Acts of Parliament, 2013 (India)
[11] Companies Act, 2013, § 234, No. 18, Acts of Parliament, 2013 (India)
[12] Competition Act, 2002, No. 12, Acts of Parliament, 2003 (India)
[13] SCM Solifert Ltd. & ANR. v. Competition Commission of India, CIVIL APPEAL NO(S). 10678 OF 2016

The main regulating body for the Indian securities market is the Securities and Exchange Board of India (SEBI). Its goal is to safeguard investors' interests in securities as well as encourage their development in the Indian market. SEBI accomplishes this, among other things, by governing the M&A procedure in the Indian securities industry.

According to SEBI regulations, companies are expected to notify stock exchanges and their shareholders about M&A transactions. This is done to make sure that investors have access to all pertinent information in order to make well-informed investment decisions. The information that needs to be made public includes the terms and conditions of the decided merger and acquisition, the company's valuations, and any foreseeable risks that might be involved in the deal. The processes to obtain stock exchange approval for mergers and acquisitions are also outlined by SEBI. A complete merger or acquisition plan must be submitted by the companies involved in the deal to the stock exchanges for approval. The plan needs to include information about the participating companies, the share exchange ratio, and the transaction's advantages and disadvantages. After reviewing the plan, the stock exchanges will decide whether or not to approve it based on whether or not it complies with SEBI regulations. In addition, SEBI mandates that businesses get shareholder approval before engaging in an M&A transaction. For the companies to get shareholder approval for the transaction, a general meeting of shareholders is required. All pertinent information regarding the transaction must be disclosed to shareholders, and they must be given the chance to voice any concerns and ask questions.

6.4 FEMA Regulations

Cross-border mergers, as addressed by the Foreign Exchange Management Act (FEMA), encompass any merger, amalgamation, or arrangement involving both Indian and foreign companies. According to the 25th rule of the Companies (Compromises, Arrangements, and Amalgamations) Rules, 2016, FEMA regulations dictate that any cross-border transaction must be conducted through the Reserve Bank of India (RBI). In 2017, an amendment to the Companies Act introduced Section 234, specifically addressing cross-border mergers. Furthermore, in 2018, the RBI issued a notification in the official gazette, soliciting input from stakeholders for the formulation of regulations. This underscores the central role the RBI plays in overseeing cross-border mergers by closely monitoring the prevailing market conditions.

6.5 The Income Tax Act, 1961

The Income Tax Act, 1961, does not regulate the procedural aspects of M&A, but it provides for tax concessions or benefits in respect of the following:

1. Amalgamations or mergers of companies
2. Amalgamation or merger of a banking company
3. De-merger of a company
4. Slump sale

Unlike the Companies Act of 1956[14], the Income Tax Act of 1961 defines amalgamation under Section 2(1B)[15], although mergers and acquisitions are not included by this definition. According to this Act, specific advantages or concessions are only given to merging companies (the target, acquiree, or merging companies) and amalgamated companies (the post-merger enlarged and the acquired) when they meet all requirements listed in different sections of the Act.

Non-compliance with the Companies Act and Competition Act can result in the imposition of penalties and the rejection of the merger or acquisition. CCI has the power to "*impose a penalty of up to 1% of the total turnover or assets of the company, whichever is higher, for non-compliance with the provisions of the Competition Act*." It may potentially result in the merger or acquisition being rejected.

7. CONCLUSION

Businesses should thoroughly weigh the advantages and disadvantages of each merger before deciding to join with another company. Law is a significant influence in governing merger and acquisition contracts, besides to numerous other aspects. The parties to a merger should be aware of all the laws that apply to them and obtain legal counsel. They risk having legal action taken against them or facing penalties if the specific regulations are broken.

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[14] Companies Act, 1956, No. 1, Acts of Parliament, 1956 (India)
[15] The Income-tax Act, 1961, § 2(1B), No. 43, Acts of Parliament, 1961 (India)