Navigating Inbound M&A in India: An Overview

Skadden | Lexygen legal consulting

August 13, 2024

If you have any questions about this overview, please reach out to one of the contacts listed on the last page, or the Skadden or Lexygen attorney with whom you normally consult.

Skadden
One Manhattan West
New York, NY 10001
212.735.3000

Lexygen
4th floor, INDIQUBE PENTA
51, Richmond Road
Bangalore 560025
India

The inbound M&A landscape in India has been experiencing a significant surge of global interest over the past couple of years. While M&A activity globally has cooled, India has emerged as a destination of choice for companies seeking to establish their supply chains or production hubs in various countries.

The activity has been driven by factors including:

- The Indian government's "Make in India" campaign
- Progressive reforms to make it easier to do business in India
- India's rising tech prowess
- A large, skilled and English-speaking workforce
- Robust domestic demand

The regulatory framework applicable to inbound M&A activity and investment in India presents unique considerations depending on, among other factors, the nature and structure of the deal, the industry sector in question, and the size and market share of the businesses involved.

This overview is a collaboration between Skadden and Lexygen, prepared for those considering pursuing deals in India and developing an overall India strategy. It summarizes the key considerations under Indian exchange control regulations, antitrust regulations, company law, securities laws and tax laws.

Exchange Control Regulations

Foreign investment in India is regulated by:

- the Foreign Exchange Management Act, 1999 (read with the rules and regulations framed thereunder, including the Foreign Exchange Management (Nondebt Instruments) Rules, 2019 and Foreign Exchange Management (Cross-Border Merger) Regulations, 2018) and
- the government's Consolidated Foreign Direct Investment Policy (collectively, "the Foreign Investment Regulations").

Types of securities. Persons resident outside India ("Nonresidents") are permitted to invest in or acquire (under the foreign direct investment route) securities of Indian companies that are:

- equity shares, including partly paid equity shares,
- fully paid and mandatorily convertible preference shares,
- fully paid and mandatorily convertible debentures, and
- share warrants.

Entry routes and sector-specific requirements. As a general rule, foreign investment is permitted in all sectors except for a specified and limited list of prohibited sectors, which include, but are not limited to, gambling and betting, tobacco, and inventory-based business-to-consumer ("B2C") e-commerce.

Foreign investment in permitted sectors may be made through either the **automatic route**, where no regulatory approval is required, or the **approval route**, where the approval of applicable regulators (*i.e.*, the Reserve Bank of India ("RBI"), Ministry of Commerce and Industry, etc.) are required.

© Skadden, Arps, Slate, Meagher & Flom LLP and Lexygen. All rights reserved.

Mandatory Approval for Acquirers From Certain Jurisdictions

Since 2020, any Nonresident (or beneficial owner of such Nonresident) that is incorporated in or is a citizen of a country sharing a land border with India (Afghanistan, Bangladesh, Bhutan, Myanmar, China, Nepal and Pakistan) will require RBI approval for any investment in India, even if such investment would, if made by a Nonresident from any other jurisdiction, fall under the automatic route.

For instance, foreign investment of up to 74% in the insurance sector is permitted under the automatic route, while investments beyond that threshold require prior approval.

Additionally, investments in certain sectors, while permitted under the automatic or approval routes, may be subject to further sector-specific requirements. For instance, foreign investment of up to 100% is permitted under the automatic route in "**single brand retail trading**" (*e.g.*, Marks & Spencer, Ikea, etc.). However, where foreign investment exceeds 51% in such businesses, local sourcing norms become applicable to the target company post-closing.

Similarly, **in the manufacturing sector**, foreign investment of up to 100% is permitted under the automatic route, provided that all the manufacturing units of the company, including its contract manufacturers, are located in India.

Pricing guidelines. All investments in, or acquisitions from Indian residents of, securities of an Indian company by Nonresidents must comply with the pricing guidelines prescribed in the Foreign Investment Regulations. The purchase price paid by a Nonresident for the acquisition of any unlisted securities cannot be less than the fair market value of such securities determined pursuant to a valuation exercise applying an internationally accepted pricing methodology.

In the case of the acquisition of listed securities, the fair market value floor price is to be determined based on the trading price of such securities on the stock exchange over a specified look-back period.

Deferred Consideration and Indemnity Escrow

In structuring M&A deals with purchase price adjustments or earnouts, it is important to note that where a Nonresident acquires securities of an Indian company from an Indian resident, only up to 25% of the aggregate purchase consideration payable by the Nonresident may be deferred, and then only for a maximum period of 18 months.

Note that in such circumstances, the initial/upfront consideration must meet the pricing guidelines (*i.e.*, the amount of initial consideration must be equal to or higher than the fair market value of the aggregate purchased securities).

Further, an indemnity escrow may be provided for up to 25% of the aggregate purchase consideration for a period of 18 months.

Any terms proposing to defer purchase consideration or create indemnity escrows exceeding such thresholds or for longer periods will require RBI approval.

In the case of the transfer of securities of an Indian company by a Nonresident to an Indian resident, the fair market value of the securities (determined in the manner stated above) is the ceiling price that the Indian resident can pay.

Exit Via Put or Call Options

Nonresidents are permitted to exit by exercising put or call options with respect to the securities they hold, provided that such rights do not offer the Nonresident an "assured return." As such, the put or call option cannot require an Indian resident to provide the Nonresident a guaranteed return (which is typically the case where the contractual clause prescribes a predetermined strike price) and must be exercised at fair market value prevailing at the time of exit.

Additionally, put or call options are only enforceable so long as the Nonresident is locked in for a minimum period of one year (or for a longer period, if so prescribed under the Foreign Investment Regulations as a sector-specific condition).

Note that these pricing guidelines do not apply to any transaction between Nonresidents relating to securities of an Indian company.

Reporting requirements. All investments in or acquisitions of securities in Indian companies by Nonresidents are required to be reported to the RBI in prescribed forms.

Inbound mergers. The conditions and restrictions discussed above also apply to the issue or transfer of securities of an Indian company to Nonresidents pursuant to a merger of a foreign company with and into an Indian company, resulting in the Indian company surviving the merger ("Inbound Merger").

While the Companies Act, 2013 and the rules framed thereunder ("Companies Act") stipulates that an Inbound Merger must be approved by the RBI, the Foreign Investment Regulations deem such approval granted based on self-certification by the companies involved that the applicable provisions of the Foreign Investment Regulations have been adhered to.

Inbound Mergers: Other Exchange Control Considerations

Inbound Mergers may also trigger compliance with other exchange control regulations. For instance, where the foreign company involved in the Inbound Merger holds any interests in entities outside India and the Inbound Merger results in the Indian company acquiring the interests in such entities, the transaction will also need to comply with the pricing guidelines, reporting requirements and other conditions under the Foreign Exchange Management (Overseas Investment) Rules, 2022 and regulations framed thereunder.

Similarly, where the foreign company involved in the Inbound Merger has outstanding borrowings from overseas sources, which become borrowings of the Indian company pursuant to the Inbound Merger, such borrowings must comply with the external commercial borrowing norms pertaining to the size of the borrowing, minimum average maturity and all-in-cost ceiling under the Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 and directions thereunder.

Downstream investment. An Indian company that is "owned and/or controlled" by Nonresidents is classified as a foreign owned and/or controlled company ("FOCC"). According to the Foreign Investment Regulations, an Indian company is considered owned and/or controlled by Nonresidents if:

- Nonresidents (whether related parties or not) hold beneficial interests in the aggregate of more than 50% of the securities of the Indian company, or
- Nonresidents have the right to appoint a majority of directors or control the management or policy decisions of the Indian company.

Any investment in or acquisition of securities of another Indian company by an FOCC ("Downstream Investment") is treated as foreign investment, and all conditions and restrictions under the Foreign Investment Regulations that apply to a Nonresident will apply in the same manner to the FOCC in connection with the Downstream Investment.

Antitrust Regulations

The Competition Act, 2002 read with the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (collectively, "the Antitrust Regulations") prohibit:

- acquisitions of (i) shares or voting rights above a specified threshold level or (ii) substantially all assets or control over an Indian company or business, and
- Inbound Mergers that in each case cause, or are likely to cause, an appreciable adverse effect on competition in India.

The Antitrust Regulations mandate notification to and approval by the regulator, the Competition Commission of India ("CCI"), for transactions that meet **any one or more** of the trigger thresholds specified therein, including transaction value thresholds or combined (for acquirer and/or target) asset or turnover thresholds in India and/or outside India.

However, even in cases where any one of the above thresholds are triggered, parties may be able to **claim exemption** from the notification and approval requirements in certain circumstances. For instance, acquisitions of ownership stakes of less than 25% without any other form of controlling interest are exempt.

Similarly, acquisitions of shares of an Indian company by certain categories of acquirers, such as banks, public financial institutions and registered foreign portfolio investors, may also be eligible for exemptions.

Additionally, **"small target" acquisitions** — where the assets and/or turnover in India of the target are below prescribed thresholds — are transactions that are deemed noncompetitive and are therefore exempt from the notification and approval requirements.

A transaction that triggers the notification and approval requirements cannot be completed until approval from the CCI has been obtained or the regulatory review period (150 calendar days from the date of notification to the CCI) has expired.

That said, certain transactions that meet the prescribed thresholds but are unlikely to have an appreciable adverse effect on competition (such as transactions where the acquirer and target do not have any horizontal, vertical or complimentary overlap in their products or services) are eligible for **green channel approval**, where CCI approval is deemed to be provided immediately on filing the notification.

Company Law

The Companies Act regulates the procedure for the issuance and transfer of securities of Indian companies.

Issuance and transfer of securities. The issuance of securities by, or transfer of securities of, an Indian company requires approval from the board of directors (except for acquisitions of listed securities made through the open market) and, in certain cases (such as the issuance of preference shares or transfers that are restricted by shareholders' agreements), shareholder approval.

Inbound mergers. While investments in or acquisitions of securities of Indian companies can be privately negotiated, Inbound Mergers require the shareholders and creditors of the Indian company to approve the scheme of merger before it is filed with and approved by the regulator, the National Company Law Tribunal ("NCLT"). The NCLT reviews the scheme of merger to ensure that the interests of all stakeholders (including minority shareholders, creditors and employees) are protected. As there are no prescribed review periods within which the NCLT is required to provide its decision, Inbound Mergers can be time-consuming.

Minority squeeze-outs. Where a scheme or contract pertaining to the transfer of securities of a target has, within four months from receipt of an offer from the acquirer, been approved by shareholders holding at least 90% of the securities of the target, the acquirer can "squeeze out" the dissenting minority shareholders by requiring them to sell their shares to the acquirer. However, the dissenting minority shareholders have a right to object to the acquisition by approaching the NCLT, and therefore this right can effectively be enforced only with approval of the NCLT.

Additionally, the Companies Act permits an acquirer who holds at least 90% of the securities of an unlisted Indian company pursuant to an amalgamation, share exchange, conversion of securities or similar event to make an offer to purchase the minority interests at a price no less than the fair market value. However, the minority shareholders are not obligated to accept the acquirer's offer and consummate the sale, and therefore minority squeeze-outs invoking this provision are largely untested.

Securities Laws

Acquisitions of listed companies are additionally governed by the regulations issued by the Securities and Exchange Board of India ("SEBI"), including the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and the SEBI (Delisting of Equity Shares) Regulations, 2021 (collectively, "the Listed Company Regulations").

Mandatory tender offer. Any acquirer proposing to acquire securities of a listed Indian company entitling it to exercise 25% or more of the voting rights or proposing to acquire control must provide an exit opportunity to the public shareholders, by making a tender offer to acquire at least a further 26% of the voting rights of the listed Indian company ("Mandatory Tender Offer") at an offer price specified by the acquirer. The requirements with respect to pricing and other procedural aspects are as prescribed in the Listed Company Regulations.

Take-private transactions. Where an acquirer proposes to take private a listed Indian company, the Listed Company Regulations permit the acquirer to also specify, in the Mandatory Tender Offer, an indicative take-private price that should include a suitable premium to the offer price. Further, the Listed Company Regulations permit an acquirer to directly (*i.e.*, without necessarily triggering a Mandatory Tender Offer) make an offer to take a listed company private. Such offer can also be made conditional on a certain level of acceptance (*e.g.*, an "all-or-nothing" offer that would bind the acquirer only if all shares of the target are tendered).

If the number of shares tendered by public shareholders in response to the Mandatory Tender Offer results in the acquirer holding at least 90% of the issued and outstanding shares ("Success Threshold"), then the take-private is considered successful. In the event the number of shares tendered by public shareholders in response to the Mandatory Tender Offer is not enough for the acquirer to achieve the Success Threshold but results in the acquirer holding more than 75%, the acquirer is afforded a period of 12 months to re-attempt the take-private deal. If the take-private fails again, the acquirer would be required to reduce its shareholding to 75% or less within a further period of 12 months to comply with the minimum public shareholding norms for listed Indian companies.

Insider trading. The SEBI (Prohibition of Insider Trading) Regulations, 2015 ("Insider Trading Regulations") prohibits trading in securities of a listed Indian company by persons who possess any "unpublished price-sensitive information" ("UPSI"). As there are no carve-outs in the Insider Trading Regulations for private investments in or acquisitions of listed Indian companies, the acquirer must take care to ensure that it is not privy to any UPSI at the time of the transaction. Acquirers may have to balance the prudential considerations of due diligence against preventing or mitigating potential liabilities on account of perceived insider trading under the Listed Company Regulations.

Tax Laws

Transfer taxes. The transfer of securities of an Indian company is subject to stamp duty of 0.015% of the market value of the securities transferred. In case of listed securities purchased through the stock exchange, while no stamp duty is payable, a securities transaction tax of 0.1% of the purchase consideration is payable.

Capital gains tax. A transfer of securities of an Indian company for gain typically attracts capital gains tax in India in the hands of the seller. The capital gains tax rate varies depending on the period for which the securities were held, and benefits under an applicable Double Taxation Avoidance Agreement ("DTAA") may be available. Where the securities of an Indian company are purchased from a Nonresident seller who has earned capital gains from the sale, the acquirer is obligated to withhold tax at prescribed rates. The rate for withholding tax may vary based on the applicable DTAA.

Further, if the deal is being structured as a purchase of a non-Indian holding company that has substantial assets and businesses in India, Indian capital gains may still be applicable, and such transactions may need certain structural or documentary reinforcements to prevent or mitigate such a tax risk.

Inbound mergers. Inbound Mergers where (i) all assets of the merging company prior to the merger vest with the surviving Indian company and (ii) at least 75% of the shareholders of the merging company are shareholders of the surviving Indian company can be tax neutral. The merging company transferring the assets will be exempt from capital gains tax on such transfer. Additionally, the shareholders transferring their shares in the merging company will also be exempt from capital gains tax on such transfer, if the entire consideration paid to them comprises of securities in the surviving Indian company.

Navigating Inbound M&A in India: An Overview

Skadden Contacts

Rajeev P. Duggal
Partner / Singapore
65.6434.2980
rajeev.duggal@skadden.com

Thaddeus (Thad) Hartmann
Partner / New York
212.735.2726
thaddeus.hartmann@skadden.com

Thomas J. Ivey
Partner / Palo Alto
650.470.4522
thomas.ivey@skadden.com

Laura A. Kaufmann Belkhayat
Partner / New York
212.735.2439
laura.kaufmann@skadden.com

Dohyun Kim
Partner / New York
212.735.2827
dohyun.kim@skadden.com

Sonia K. Nijjar
Partner / Palo Alto
650.470.4592
sonia.nijjar@skadden.com

Amr Razzak
Partner / Palo Alto
650.470.4533
amr.razzak@skadden.com

Jonathan B. Stone
Partner / Hong Kong
852.3740.4703
jonathan.stone@skadden.com

Lexygen Contacts

Vijay Sambamurthi
Founder and Managing Partner
65.8524.7863
vijay@lexygen.law

Codhai Raghavan
Partner
91.99165.34107
codhai@lexygen.law

This overview is provided by Skadden, Arps, Slate, Meagher & Flom LLP (Skadden) and Lexygen for educational and informational purposes and is not intended and should not be construed or deemed in any manner whatsoever to be a legal opinion or legal advice. Neither Skadden nor its affiliates practice Indian law. Readers should consult Indian legal counsel before taking any action in relation to the matters discussed in this overview.

This overview has been prepared relying on the relevant provisions of applicable Indian laws, and judicial and administrative interpretations thereof, if any. It may also contain some of our own analysis on certain issues. Such laws and judicial and administrative interpretations thereof could be subject to change or modification by subsequent decisions of competent legislative, regulatory, administrative or judicial bodies. Accordingly, any such change or modification could affect the validity of our analysis or conclusions contained herein.

While we make every effort to ensure that this overview is accurate in all material respects, we strongly recommend that you seek legal advice for specific situations and not act solely on the basis of anything stated herein. Skadden and Lexygen undertake and accept no liability whatsoever with respect to any of the contents herein. This overview may be considered advertising under applicable state laws in the United States.