



Merger & Acquisitions Industry Alert

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Mergers and Acquisitions Industry Alerts

For working out a strong M&A deal, a prompt due diligence is a must to minimize any potential risk. This newsletter will focus the three important aspects to be considered when beginning a due diligence.

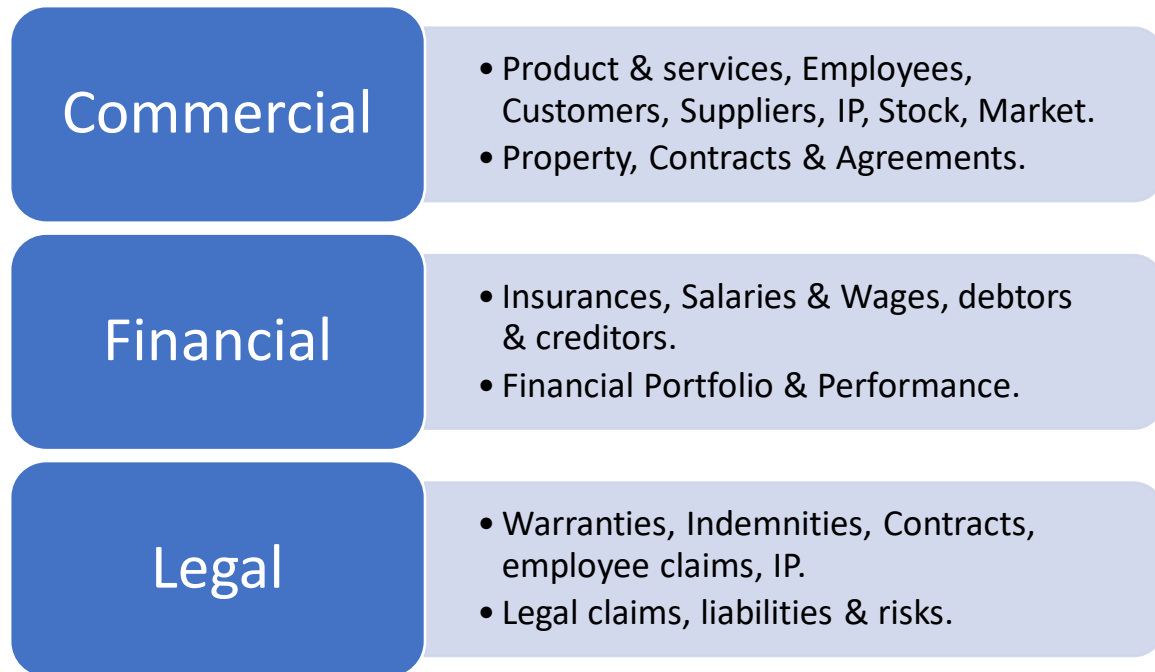
What are the Issues to be contemplated by the M&A parties?

Even before the commencement of Due Diligence, some of the relevant considerations must be deliberated by the concerned parties to remain in consensus with the legality of the deal. These issues are:

- 1) Tax Issues: In a cross-border M&A, taxes can never be ignored. Various relevant taxes such as stamp duties, VAT etc are to be discussed first rather than wait for the due diligence to begin and contemplate it later. Thus, agreements should be made where the liability towards the accruing taxes must be assigned beforehand. Thus, this shall mitigate risks/ disputes later. Also, consensus on tax credits/ tax incentives must be negotiated together.
- 2) Due Regard to the Competition laws: M&A transactions are usually never devoid of issues wrt anti-competitive agreements. The parties must adhere to the relevant legislations on the respective Competition laws especially the Acquirers must run legal research on the legalities of the deal structure and transaction. This shall call for the “Clean Team Deals” that shall be discussed later.
- 3) Political issues: There are industries which are politically sensitive such as defense, aviation, technology etc. Thus, basic understanding on the industry to be considered in the deal is always advisable in order to minimize any possible Antitrust setback.
- 4) The Deal Structure: The commercial aspects of a deal must be contemplated in consonance with the commercial objectives of the acquirer, tax, finances and the regulatory frameworks. Questions like whether the transaction should be asset or stock purchase, how should the transactions commence etc must be addressed.

What are the Types of Due Diligence?

Broadly, there are 3 types of Due Diligence involved.



Thus, consideration of the abovementioned types of Due Diligence can ease the process of documentation and thereby help the parties into organizing their workload.

So, what Questions should be raised when commencing Due Diligence?

The buyer must consider asking such questions to the target company:

- I. Finance.
 - What are the financial statements of the last three years of the company?
 - Has it been audited?
 - How many assets and liabilities are present?
 - What is the profit margin?
 - State of indebtedness.
 - How much working capital shall be required?
- II. Intellectual Property

- What registered and common law trademarks and service marks does the company have?
- What copyrighted products and materials are used, controlled, or owned by the company?
- Does the company's business depend on the maintenance of any trade secrets, and if so what steps has the company taken to preserve their secrecy?

III. The Overall Sales

- Who are the top 10 customers and what revenues are generated from each of them?
- Are there any warranty issues with current or former customers?
- What are the sales terms/policies, and have there been any unusual levels of returns/exchanges/refunds?

IV. Relevant Contracts

- Settlement agreements
- Past acquisition agreements
- Equipment leases
- Indemnification agreements
- Employment agreements
- Exclusivity agreements
- Franchise Agreements
- Non-Competition agreements
- Power of Attorney.

What are the respective provisions and compliances regarding “Clean Team Deal” in India?

It is fundamental that a buyer in any M&A transaction understands the business of a target entity before committing to a transaction. This is particularly relevant for private company transactions, where such details cannot be obtained from publicly available information. That being said, information exchange prior to completion of a transaction may also pose competition law issues. This is because competition laws require parties to a transaction to remain independent competitors until a transaction is closed. Failure to do so is referred to as ‘gun jumping. Hence, to balance

the twin objectives of obtaining information about the target company and preventing any potential violation of competition law, companies are increasingly setting up ‘clean team’ arrangements.

A ‘clean team’ is a group of employees or consultants who work for a buyer guided by a set of procedures agreed upon by both the buyer and the seller. The members of a clean team should have no existing responsibility for setting prices, other terms of sale, or marketing strategy for competing products.

An exchange of commercially sensitive information that facilitates an action in concert would likely be (and has in practice been) seen as a violation of Section 3(3). India has a mandatory suspensory regime where transactions which require a notification to the Competition Commission of India (CCI) pursuant to the Competition Act, 2002 (Act) are required not to consummate the transaction in part or whole before the CCI clearance or the expiry of the waiting period of 210 days. Since 2011, while the CCI has passed significant number of orders under Section 43-A of the Act penalizing companies which have partly/wholly consummated the transaction before the same is notified to the CCI or before the receipt of approval, thus far there has been no specific decision in relation to gun jumping issues relating to information exchange. However, the CCI in its recent order in Hindustan Colas (P) Ltd./Shell India Markets (P) Ltd¹ has furthered its jurisprudence by holding that pre-payment of consideration constitutes gun jumping as it creates a tacit collusion which may cause an adverse effect on competition even before consummation of the transaction, effectively stating that the actions of the parties which can have a possibility of affecting the independent behaviour of the transacting parties could be amenable to antitrust scrutiny².

The issue of what affects the independent behaviour of transacting entities prior to the final closing is somewhat foggy in India. However, what is rather clear is that while the exchange of benign information between the parties pre-closing is permissible, information which is commercially or competitively sensitive in nature such as strategic pricing information etc. would constitute “gun jumping” and therefore frowned upon.

What the Compliance Manual by CCI says:

In cases where a company plan acquiring a stake in, control of, or entering into a joint venture agreement with its competitor, it should adhere to the following norms whilst conducting its due diligence in order to assess the viability of such an arrangement with its competitor:

¹ Combination Registration No. C-2015/08/299

² <https://www.scconline.com/blog/post/2018/08/16/exchanging-information-is-your-team-clean-enough/>

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- a. Due diligence exercise on a competitor should be conducted via the Legal Department or a third party, and NOT by any member of the company who is associated with the day to day operations of the company;
 - b. Personnel on behalf of the Legal Department or the third party should be bound by a Confidentiality/NonDisclosure Agreement, in order to ensure that the information/data so collected by him/her it must not be divulged to any other competitor operating in the same market or commercially used by the company itself which is conducting the due diligence;
 - c. Exchange or transfer of forward-looking planning documents or details of pipeline projects or strategic plans, between competitors can pose anti-competitive risks, as they are considered to be commercially sensitive;
 - d. Cost data, pricing and discount policies that are not publicly available should not to be exchanged in course of the due diligence.
- **1.5 Consequences of Non compliance**

Non-compliance with the provisions of the Act can result in the following:

- i. Initiation of inquiry
- ii. Cease and desist and Imposition of monetary penalty of enterprise
- iii. Individual liability
- iv. Adverse Reputational effect
- v. Aggrieved enterprise filing suit

As per Section 53N of the Act, compensation can be granted, on an application, by the Competition Appellate Tribunal (COMPAT) to any person for loss or damage, shown to have been suffered by such person as a result of a contravention of the provisions of the Act.