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STATUTORY AND REGULATORY BODIES OF REVERSE TRIANGULAR MERGERS IN INDIA

ABSTRACT[1]

Cross border mergers are increasing by the day not only globally, but also in India. An Indian company can acquire control of an overseas company with the application of American depositary receipt and global depositary receipt share swap transitions, provided that the Indian company is listed on any overseas stock exchange. Although this type of merger is predominantly noticed in countries like the United States and United Kingdom, India has had quite a few occasions wherein companies merged using the option of reverse triangular merger.

There have been several instances of reverse triangular mergers which have been regulated by the Competition Commission of India (CCI). The manner in which the CCI adjudicated and managed the affairs of such mergers is intriguing. While dealing with such combinations of mergers, the CCI's primary objective is to ensure that they do not have any adverse repercussion on the competition in India. After all, the paramount idea behind establishing the CCI is "to prevent practices having adverse effect on competition and to promote and sustain competition in markets."[2]

The CCI plays a major role in deciding the fate of reverse triangular mergers in India's competitive atmosphere in the marketplace. Thus, this research paper will delve into the nuances and intricacies of reverse triangular mergers in India. Moreover, it will comprehensively examine the role played by the CCI in such mergers. Apart from this, the paper will also explore the taxation aspect in reverse triangular mergers and obstacles to such a merger.

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[2] The Competition Act, 2002, No. 12, Acts of Parliament, 2003 (India).

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I. INTRODUCTION

Mergers and Acquisitions ("M&A") play an important role in the growth and structuring of the corporate market. Companies decide to combine their forces with a merger or choose to acquire a company as there are several benefits that could be achieved by such an amalgamation. Companies aim to expand their market share, capture new markets, reduce competition, increase profits, and diversify products through M&A.

There are numerous kinds of mergers that take place between companies, which include horizontal mergers, vertical mergers, conglomerates, etc. Similarly, triangular mergers are types of mergers which are generally put into action when companies aim for cross border mergers or aim to seek for expansion, tax benefits etc. In a standard triangular merger structure, the acquiring company creates a wholly- owned subsidiary for the purpose of merging with the target company. In this way, the target company and the subsidiary of the acquirer company merges to form a single entity. Subsequently, the acquirer company becomes the parent company of the merged enterprise. This is the conventional method to go about with a triangular merger but there is a minor distinction between a forward triangular merger and a reverse triangular merger.

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In reverse triangular merger, the acquirer company's subsidiary merges with target company where in the former liquidates, as a result of which the target company is the surviving entity. In this way, the target company becomes a subsidiary of the acquirer and the former's shareholders will receive stock in the acquirer or will get cash in return for their equity.

For example, X is a parent company which has created a 'merger subsidiary', Y, for the purpose of acquiring Z. Here, Y will merge with Z, after which the former will liquidate thus making X the parent company and Z, the Subsidiary of X. On the other hand, in a forward triangular merger, the target company (Z) dissolves, and the subsidiary (Y) is the surviving entity. Thus, in both instances, the parent company will be the same entity. The only difference is the surviving entity as in forward triangular merger, the merger subsidiary will be the surviving one where as in reverse triangular merger, the target company will be the surviving one.

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There is a myriad of upsides to a reverse triangular merger. Since, the target company is surviving, the merger takes place at a rapid rate as minimal consent is required from third parties who would object if the target company disappeared. "It also only requires less than all of the target company stockholders."[3] The merger also keeps the target company's existing contract with its customers in place which would be beneficial to the acquirer as it can keep the desirable contracts running which would be terminated if the former ceased to exist.[4] Moreover, the acquirer can also reduce its exposure to the liabilities of the target company by running it as a subsidiary entity.[5] Apart from this, the acquirer can also easily dispose off or sell the target company as it would not have been fully integrated into the former's entity. Reverse Triangular mergers could be more beneficial as the acquirer company does not only hold the shares, assets, and liabilities of the company, but it also holds rights such as special licenses, leasing, contracts of the target company, franchises of the target company and many other key features which would be unavailable in forward triangular mergers.

II. RESEARCH METHODOLOGY

The methodology that will be undertaken in this research, will be mainly doctrinal in nature. This approach of research will help the researchers in the interpretation of statutes and analyzing both primary and secondary material which include various books, article, journals, judicial interpretation, and other legal sources. Doctrinal methodology of research helps in comprehending the meaning of ambiguous wordings, phrases and classify the issue of research in defined parameters. Hence, doctrinal methodology of research will be undertaken to reach a conclusion with regards to the topic of research.

III. ROLE OF COMPETETION COMISSION OF INDIA AND REVERSE TRIANGULAR MERGERS

[3] RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 670-71 (Foundation Press 1995); PETER V. LETSOU, CASES AND MATERIALS ON CORPORATE MERGERS AND ACQUISITIONS 10-12 (Wolters Kluwer Law and Business 2006).
[4] Kerry Tomasevich, Forward or Reverse: What's Involved in a Merger?, MASS HIGH TECH: THE JOURNAL OF NEW ENGLAND TECHNOLOGY, Dec. 9, 2002.
[5] *Id.*

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The legal and judicial aspects concerning reverse triangular mergers are predominantly dealt in the Competition Act of 2002 and in the Regulation prescribed by the CCI. The core purpose of the Act is to discourage anti-competitive practices in the marketplace and to curb dominance, thus limiting monopolistic tendencies. 'Combinations' in the context of mergers basically refers to the combining of two firms or enterprises, thus pooling in resources to run as an individual entity. "Broadly, combination under the Act means acquisition of control, shares, voting rights or assets, acquisition of control by a person over an enterprise where such person has direct or indirect control over another enterprise engaged in competing businesses."[6]

It can be interchangeably used with the terms 'merging' or 'amalgamation' as long as the combination reaches the threshold established in the act. So, the legal dimensions of reverse triangular mergers are dealt with respect to the regulations and laws concerning combinations. The adjudicating body for the same has mostly been the CCI and it ensures that the combinations entered into by the firms do not have any adverse impact on the competition in India. This is the rudimentary outline of the legal facets with respect to reverse triangular mergers. The significant rulings of the CCI with respect to the application of the Competition Act, 2002's regulations are listed below.

Section 6(2) of the Competition of Act, 2002[7] deals with the notice that is to be provided to the commission when enterprises enter into a combination arrangement. So once the board of directors of the companies give consent to the merger, the notice needs to be filed within a week laying out the intricacies of the combination. For example, in the order of ***Computer Sciences Corporation and Hewlett Packard Enterprise Company***[8], a notice was given to the commission after the decision of the board of directors for a new combination. The proposed combination set forth the nuances of the merger the companies were willing to enter into, which turned out to be a reverse triangular one.

Section 20 (4) of the Competition Act of 2002[9] provides the factors that can be considered by the commission while determining whether a particular combination would have an adverse effect on the competition in the country. Some of the main factors include competition via

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[6] *Provisions relating to Competition*, COMPETITION COMMISSION OF INDIA, (Jul. 9, 2021, 10 PM), https://www.cci.gov.in/sites/default/files/advocacy_booklet_document/combination.pdf.
[7] The Competition Act, 2002, § 6, cl. 2, No. 12, Acts of Parliament, 2003 (India).
[8], 2016 SCC OnLine CCI 163.
[9] The Competition Act, 2002, § 20, cl. 4, No. 12, Acts of Parliament, 2003 (India).

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imports, scale of barriers to enter the market, level of combination, substitutes availability in the market, extent of vertical integration, possibility of a failing enterprise etc. The commission can also inspect as to whether the benefits that could potentially arise of the combination can outweigh its possible adversities. Thus, while assessing a merger, the commission can very well take into account these factors before providing a judgement.

This way, there is order and consistency in the process. In the order of ***Bayer AG[10],*** the commission was adjudicating on a combination provided by the company under section 6(2) of the Competition Act of 2002. While arbitrating on its judgement, the commission relied upon the factors provided under section 20(4). Subsequently, after weighing in those factors, it was of the view that the agreed upon combination would have an adverse effect on the competition in India and thus recommended modifications.

Section 31 (1) of the Competition act of 2002[11] gives the Commission powers to approve a combination should it feel that it will not have any adverse impact on the competition. Thus, by an order, the Commission can give its assent to a combination filed as a notice under section 6(2) of the act. For example, in the order of ***Abbott Laboratories[12]***, the commission was of the opinion that the proposed combination as provided in the notice issued by the company would not have any adverse effect on competition in India. Thus, it accepted the notice under section 31(1), giving green light for the companies to proceed with the said combination structure.

Section 57 of the Competition Act of 2002[13] protects the companies' interest by not disclosing information obtained for the purpose of the act. Thus, if the Commission received any information regarding an enterprise, it cannot disclose the same without a prior written consent of the latter. In the order of ***Clariant Limited, Hurricane Cyclone Corporation and Huntsman Corporation,*** the commission reiterated the provisions of this section.

It mentioned in it order that the information related to the combination and parties will not be disclosed. It said "The information provided by the parties shall be treated as confidential in terms of and subject to provisions of Section 57 of the Competition Act of 2002."[14] This is a routine practise followed by the commission to protect the interests of the companies.

[10] 2018 SCC OnLine CCI 69.
[11] The Competition Act, 2002, § 31, cl. 1, No. 12, Acts of Parliament, 2003 (India).
[12] 2016 SCC OnLine CCI 83.
[13] The Competition Act, 2002, § 57, No. 12, Acts of Parliament, 2003 (India).
[14] 2017 SCC OnLine CCI 98.

Section 43A of the Competition act of 2002[15] vests the commission with powers to impose penalties on enterprises that fail to provide necessary documents under section 6(2) of the act. The commission can set a penalty that can go up to one percent of the total turnover of assets of the combination. In the order of ***Johnson Controls, Inc. ("JCI") and Tyco International Plc ("Tyco")***[16], the commission looked into the matter of delay in filing notice and found out that the companies delayed by one day from the deadline. But the commission resorted to ***regulation 7 of the "The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011"***[17] which said that the commission, without prejudice, can admit a notice even if it is received beyond the time limit as per section 6(2) of the Competition act of 2002. This is because in this particular case, the parties believed the combination to be an acquisition when it was really a merger as per the provisions of the act. Moreover, they also continuously engaged with the commission since the time of pre-filing the consultation. Thus, the commission was of the opinion that it was a bona fide reason and thus no proceedings were taken under section 43A of the act.

Section 29(1) of the Competition Act of 2002[18] provides the commission with authority to issue notice when it feels that a particular combination is causing or likely to cause adverse impact on the competition. Thus, the notice requires the firms to revert within 30 days providing reasons as to why an investigation should not be carried on by the commission. In ***Bayer AG***[19]**,** the commission after analysing the details provided in the notice and the responses of the company, formed a prima facie opinion that the combination would likely have an adverse effect on the competition in India. Thus, while wielding its power under section 29(1), the commission issued a show cause notice asking the parties to respond within 30 days stating why an investigation should not be performed on the proposed combination.

Section 36 (3) of the Competition Act of 2002 states that "The Commission may call upon such experts, from the fields of economics, commerce, accountancy, international trade or from any other discipline as it deems necessary, to assist the Commission in the conduct of any inquiry by it."[20] In the order of ***Denali Holding Inc.***[21], the commission used its powers under section

[15] The Competition Act, 2002, § 43A, No. 12, Acts of Parliament, 2003 (India).
[16] 2016 SCC OnLine CCI 155.
[17] CCI (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011, Reg.7.
[18] The Competition Act, 2002, § 29, cl. 1, No. 12, Acts of Parliament, 2003 (India).
[19] *Supra* note 6.
[20] The Competition Act, 2002, § 36, cl. 3, No. 12, Acts of Parliament, 2003 (India).
[21] 2016 SCC OnLine CCI 154.

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36(3) combined with regulation 19(3) of combination regulations and combination 52 of the general regulations to look for expert opinions related to the issue of IT industry in India and its growth over the years. The experts on market dynamics gave their suggestions regarding the business forecast. This way, the commission can rely on the wisdom of people with expertise while adjudicating on the combinations.

In all the above-mentioned cases, the CCI adjudicated on reverse triangular mergers using the application of the Competition Act, 2002 and the CCI's Regulations. The cases mentioned above are the only instances when reverse triangular mergers were administered by the CCI.

IV. TAX BENEFITS IN REVERSE TRIANGULAR MERGERS

In India with regards to reverse triangular mergers, the main criteria to analyze if there are any capital gains on tax liability is to understand whether there is transfer of capital asset, this transfer of asset must include the extinguishment of rights in a capital asset to comply with the Income Tax Act of 1961. In the case of ***Grace Collis v. The Commissioner of Income Tax***[22] the apex court stated the definition of the term 'transfer' which is defined in the ***Section 2(47)*** of the Income Tax Act[23] includes 'the extinguishment of any rights in capital assets' and as per to the procedure of amalgamations the rights of the existing shareholders in the company would by extinguished, this would amount to the 'transfer' of capital asset. This decree makes mergers in general taxable as they are not specifically exempted by ***Section 47 (VII)*** of the Income Tax Act, 1969[24]but in cases of cross border mergers, it is not possible to comply with the provision stated in Section 47 (VII) of the Income tax act.

For example, if the target company is based in U.S and the company already has pre-existing operations in in the country of India, these units or operations are capable to availing income tax exemptions which are mentioned in the ***Sections 10(A) and 10 (B)*** of the Income Tax Act, 1969[25]. Then it would be essential to structure the merger in such terms that there is no subsequent loss of tax benefits. In such cases, if the structure of a merger is formed as a reverse triangular merger instead of other mergers, it will reduce the risk of loss with regards to tax

[22] Grace Collis vs. the commissioner of Income tax, 2000 48 ITR 323.
[23] IT Act, § 2(47), No. 43, Act of Parliament, 1961 (India).
[24] IT Act, § 47 (VII), No. 43, Act of Parliament, 1961 (India).
[25] IT Act, § 10 (A), No. 43, Act of Parliament, 1961 (India).

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benefits in sections 10 (A) & (B)[26]. Nevertheless, if there is a loss in tax benefits, the alternative method to achieve tax benefits could be availed by the application of ***Section 80*** HHE of the Income tax Act, 1969[27].

V. OBSTACLES IN REVERSE TRIANGULAR MERGERS

In cross border mergers, when share swap transactions are put into action there are certain implication that arise due to the Securities and Exchange Board of India's Disclosure and Investor Protection Guidelines of 1999[28] with regards to the preferential basis of share allotments. These guidelines provide instructions with the issue of shares on preferential basis stating that an India company which is listed on any stock exchange shall mandatorily comply with prescribed pricing formula.

The prescribed pricing formula is the weekly average high and low of the share price, this average should be calculated taking into consideration a period of six weeks from the date that the India listed company passes the resolution which approves the allotment of shares on a preferential basis to the overseas company which is a party to the reverse triangular merger. The Indian listed company must file an application to the Securities and Exchange Board of India (SEBI) requesting an exemption from this provision.

When the Indian listed company that seeks to acquire has potential interest in the management team and employees of the company, and the foreign company have outstanding stock options that have been provided to the management and employees, the applicability of the SEBI Employee Stock Ownership Plan (ESOP) Guidelines[29] falls into action.

The ESOP guidelines states that it is a mandate lock-in the stocks from one year from the date of the grant of the stock option till the date of the vesting of the option. As the ESOP guidelines do not contain any clause for the assumption of stock options, in an acquisition the outstanding stock of the foreign acquired company would have to be 'assumed' by the Indian listed acquiring company.

[26] IT Act, § 10 (B), No. 43, Act of Parliament, 1961 (India).
[27] IT Act, § 80, No. 43, Act of Parliament, 1961 (India).
[28] SEBI, DIP Guidelines, 1999 (India).
[29] SEBI, ESOP Guidelines, 2014 (India).

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Due to these guidelines, the management and employees of the foreign acquired company would have to wait for an extra year from the date of the reverse triangular merger before the stock options are vested to the employee and management team. These SEBI guidelines could possibly cause hindrances and obstacles in the path of reverse triangular mergers in India.

In the early 2000, American Depositary Receipt (ADR) and Global Depositary Receipt (GDR) share swap transition were permitted to a company that belonged to the sectors of Information Technology, the pharmaceutical sector, the biotechnology sector, and entertainment software sectors. It was only from April 2001, that the Ministry of Finance and the Reserve Bank of India gave permission for such share swap action to all the Indian companies that were listed on overseas stock exchange.

The Reserve bank of India (RBI) also issued certain regulation on the overseas direct investment that is needed for an automatic route for the application ADR/GDR share swap transitions. The regulations state that the total value of the ADR/GDR share swap transaction should not exceed the threshold of $100 million or 10 times the export income of the acquirer's company within the financial year. The evaluation of the share price of a foreign target company is made on the basis of the monthly average price of the foreign target company on any foreign stock exchange for three months including the month when the amalgamation is taking place. When the foreign target company is not listed in any stock exchange, then the recommendations and calculations of an investment banker could be considered.

During the application of plain equity share swap transitions, it is a mandate for the foreign company to seek approval from the Foreign Investments Promotion Board for the foreign company to be able to receive shares in the Indian listed company. On the other hand, during the application of ADR & GDR share swap transactions, there is not prior approval of the Foreign Investments Promotion Board (FIPB) mandatory as such transactions are specifically exempted these requirements of the FIPB given that certain conditions and followed.

VI. CONCLUSION

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Reverse triangular merger come with their own pros and cons, such mergers could prove to be efficient if applied in right situations and manners. When acquiring company aims to get hold of foreign company through cross border merger practices and their various special licenses, employees and management, franchises reverse triangular mergers would seem to the most viable option for companies to acquirer foreign companies.

The SEBI and RBI have guidelines that regulate such transactions and administer amalgamations of such sort to ensure there are no malpractices with issue and exchange of shares. The CCI also plays a role of imperial importance with the regulation of reverse triangular mergers in India. They ensure that there are no anti-competitive practices that would result in any unfair market share of companies that are combining in contracts of amalgamations.

There are numerous methods of initiating and processing cross border mergers between Indian and foreign companies, with reverse triangular mergers there are several taxation benefits that could also be availed along with several other benefits and exemptions that could be achieved by structuring an efficient reverse triangular merger.

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