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Analysing developments impacting business

LEAVING NO STONE UNTURNED – AMENDMENTS TO RULES OF CROSS BORDER MERGERS

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Introduction

In April 2020, the Government of India for curbing opportunistic takeovers / acquisitions of Indian companies due to the COVID-19 pandemic reviewed the Indian foreign direct investment (**FDI**) policy and issued Press Note No. 3 (2020 Series) (**PN3**) amending FDI policy as contained in Consolidated FDI Policy, 2017.

Further, in spirit of PN3, the Ministry of Corporate Affairs has notified amendments to Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 (**Rules**) on 30 May 2022 vide the Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2022 (**Amendment**).

The Amendment mandates a declaration in Form No. CAA.16 to be submitted before the National Company Law Tribunal (**NCLT**) at the stage of submission of application under Section 230 read with Sections 232 and 234 of the Companies Act, 2013 (**Act**) for cross border compromises or arrangements or mergers (**Cross Border Mergers**) between an Indian company and a company or body corporate which has been incorporated in a country which shares land border with India.

Analysis

The declaration requires the names of the transferor and transferee companies along with an affirmation of whether a prior approval under the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (**NDI Rules**) is required to be obtained or not. In case a prior approval under the NDI Rules is required, then such approval would have to be enclosed as part of the declaration in Form No. CAA.16 with the application to be filed under Section 230 of the Act before the NCLT.

Under the NDI Rules, the issue of equity instruments to the shareholders of the transferor company resident outside India pursuant to a NCLT sanctioned Cross Border Merger is subject to compliance with the attendant conditionalities of investment by a person resident outside India. Further, government approval is mandatory where there is a likelihood of breaching the attendant conditionalities.

In terms of the NDI Rules, investment by a person resident outside India being an entity of a country, which shares land border with India or the beneficial owner of an investment into India who is situated in or is a citizen of any such country, requires prior approval of the government. Further, in the event of transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within purview of the aforesaid restriction, would require prior approval of the government as well.

Comments

The PN3 was introduced for limiting opportunistic takeovers / acquisitions of Indian companies that had low valuations due to COVID-19 pandemic by entities in countries sharing land border with India. The restrictions under PN3, incorporated in the NDI Rules as

discussed above, mandates a government approval for any direct as well as indirect investment by way of mergers, compromises or arrangements.

The Amendment attempts to harmonise the NDI Rules and the Act. However, since the declaration is required to be made a part of the application under Section 230 of the Act, the parties to the merger will need to seek the approval of the Reserve Bank of India (**RBI**), if any, prior to filing of the application with the NCLT under Section 230 of the Act. Given that, the approval of the RBI and sanction to the Cross Border Merger by the NCLT will have to be sought separately and not simultaneously, the parties will need to take into consideration the commercial impact on the transaction on account of the added timelines.

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