

# Market And Regulatory Dynamics And Developments For India–United States Cross–Border Investments



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The United States and India, two of the world's largest economies, have witnessed a surge in bilateral trade and investment over the past decade. This dynamic partnership has been fueled by a confluence of factors, including robust economic growth, complementary strengths, and shared geopolitical interests. As both nations continue to evolve, understanding the intricate interplay of market dynamics, regulatory developments, and deal trends is crucial for businesses operating in this burgeoning market.

In this collaborative article between Sidley Austin LLP and Khaitan & Co, we explore the latest market and regulatory developments on both sides of the Pacific, analyze emerging deal trends, and discuss the opportunities and challenges facing businesses seeking to capitalize on this growing partnership.

## Market dynamics

**Maturing public market for exits:** Exits for financial sponsor-backed companies are increasingly led by securities being listed in the public market rather than more common sale exits primarily due to the recent growth in the Indian and United States stock markets. Several financial sponsor-backed companies have listed their securities in the primary market in recent months and many others are in the process of doing so in the coming months, with an intent to primarily provide full or partial exits to financial sponsors.

**Investment flow:** With higher interest rates, there was a slowdown in financial sponsor-backed investments during the last two years. Private equity investments continued to flow into sectors where there was a scope of value creation. Sectors such as artificial intelligence (AI); banking, financial services, and insurance; industrials and manufacturing; cements; retail; consumer goods; real estate; infrastructure (including renewables and digital infrastructure); and healthcare and life sciences continue to see heightened activity, and private equity investments are expected to increase as interest rates are projected to decrease during the next year.

**Buyouts are more common:** Financial sponsors are still focusing on buyouts (including bolt-on acquisitions by financial sponsor-backed strategics to add topline) rather than minority acquisitions. That being said, there is a growing market of financial sponsors participating in direct lending and growth equity to seek compelling returns for investors.

**Venture capital investments are elusive outside of AI:** Green shoots in venture investments are being witnessed in AI with billions of dollars of investments, but non-AI investments are more selective and at tempered valuations (owing to a recalibration of the valuation of tech stocks globally) — there is a strong emphasis on non-AI valuations being supported by robust key performance indicators.

**Flip structures:** Multiple financial sponsor-backed companies with operations in India are looking at inversion structures, where the capitalization table consolidates into the Indian entity. This is done generally to access Indian public markets. Other reasons attributed include costs and synergy benefits associated with the consolidation of operations in India.

**Key management equity incentives:** Financial sponsors are looking at innovative methods to structure key management equity incentives in a tax-efficient manner. Profits interests (which are generally subject capital gains tax treatment on exit in the United States) have become the most common form of equity incentive in the United States for private equity portfolio companies, while venture capital portfolio companies continue to predominantly rely upon stock options (which are generally subject to ordinary income tax treatment on exercise in the United States). Indian and U.S. income tax authorities are also keeping a keen eye on such developments and related transactions to ensure compliance with applicable tax laws.

## Regulatory developments.

**Potential tariffs:** U.S. President Donald Trump has enacted numerous tariffs on imports from foreign countries including China. These tariffs have the potential to increase Indian exports into the United States, but President Trump has also threatened reciprocal tariffs on imports from India and several other countries until such countries agree to remove tariffs on U.S. imports and commit to not creating new currencies or backing other currencies that could replace the U.S. dollar. Such tariffs on India could reduce trade between India and the United States and result in price increases and slower economic growth in such markets.

**Share swaps:** Indian exchange control laws now permit both inbound primary share swaps where an Indian company would issue shares against shares of a foreign company held by a foreign person and secondary swaps where Indian-resident entities could swap shares of an Indian company with shares of a foreign entity potentially held by a foreign person.

**Antitrust developments:** Antitrust merger thresholds have been reduced in India, which means that more transactions will now come under the regulatory purview of the Competition Commission of India. Transactions with substantial business operations in India that exceed the newly established deal value threshold (~US\$245 million) will possibly require the transaction to be notifiable to the Competition Commission of India. Antitrust regulatory authorities in the United States have significantly increased challenges to potential transactions, enforcement actions against companies, and regulations generally prohibiting non-competition agreements (which regulations have been held up by U.S. courts) to heighten competition for the benefit of U.S. consumers in recent years. Such activity is generally expected to decrease under President Trump, but he has indicated that he intends to pursue large technology companies for stifling competition. To this end, the U.S. Department of Justice recently sued to block the acquisition of Juniper, the third-largest provider of enterprise-grade wireless local area network solutions, by Hewlett Packard Enterprise (HPE). The complaint filed alleges that the

acquisition, if consummated, could eliminate fierce “head-to-head competition” and would result in two companies — Cisco Systems, Inc. and HPE — controlling a significant chunk of the market.

**Restricted countries:** Foreign direct investments in India from China and other countries that share land borders with India continue to be restricted. The Indian government has opened investigations into multiple companies that are beneficially held by persons from restricted countries.

**Significant beneficial ownership:** Indian and U.S. regulators are asking certain companies to make disclosure of significant beneficial ownership and imposing significant fines on companies which have not. An interpretation from Indian authorities is also emerging that requires executive officers of parent companies to be regarded as significant beneficial owners, where the entity is professionally managed otherwise.

**Dematerialization of shares:** To adapt to evolving markets and digitalization, the Indian government has announced a phased, mandatory dematerialization of shares, while allowing certain exemptions for smaller companies. However, subsidiary companies — regardless of whether they are Indian-owned and controlled or foreign-owned and controlled — do not receive any exemptions, even if they qualify as small companies.

**Changes to outbound investment laws:** Indian laws on outbound investments were replaced in August 2022. The new laws have sought to rationalize current regulations, which could potentially impact change of control transactions at a non-Indian holding company with an Indian subsidiary. The new laws have also introduced additional compliances and regulatory intimations.

## Deal trends

**Purchase price adjustments:** In sell-side transactions, there has been a consistent shift toward upfront payment of purchase price, supported by warranty and indemnity (W&I) insurance primarily in private company sales. W&I insurance has become a common replacement for escrows and/or holdbacks given the large number of insurers in the market and related competitive pricing and terms. We have also continued to see private company transactions in the United States generally adopting purchase price adjustments based on cash, debt, transaction expenses, and working capital. However, the regulatory regime applicable for cross-border transactions in India limits the adoption of purchase price adjustment-related constructs.





**Caps on fundamental warranties and indemnities:** Warranties and indemnities relating to authority, capacity, and title (and brokers in the United States) are generally considered to be fundamental. Historically, it was often considered that fundamental warranties and indemnities would be uncapped in time and value. However, the trend in recent years points toward reliance by buyers on W&I insurance or, in certain circumstances including smaller transactions where W&I insurance is not available or economical, capping liabilities associated with fundamental warranties and indemnities with temporal and value caps. Thirty-two percent of the Indian transactions and 97% of the U.S. transactions reviewed included a temporal cap that was less than 10 years from closing. Sixty-eight percent of the Indian transactions and 92% of the U.S. transactions reviewed had a monetary cap of 1x the amount of the purchase consideration.

**Business warranties:** From among the transactions reviewed, 69% of Indian transactions and substantially all of the U.S. transactions included warranties on the target's business and operational matters. In terms of limitations, 66% of Indian transactions with business warranties had a temporal cap between two and four years, and 24% of those transactions had a temporal cap that was more than four years. In terms of value caps, a considerable number of the Indian transactions with business warranties (59%) linked the monetary cap for business warranties to 1x the amount of the purchase consideration, while 33% of such transactions reflected up to 50% of purchase consideration. On the other hand, only 1% - 3% of U.S. private company transactions had a temporal cap in excess of two years for business warranties (with 79% - 84% between one and two years) and 75% of U.S. transactions including W&I insurance did not have any survival period for business warranties.

**Indemnities for breach of covenants:** It is fairly common for Indian and U.S. transactions to include an indemnity for breach of covenants under transaction documents except where there is no survival of representations and warranties, as in most U.S. transactions including W&I insurance. Sixty-six percent of the Indian transactions and 94% of such U.S. transactions reviewed included an indemnity for breach of covenants. The indemnity in India is typically only limited to key identified covenants, whereas in the United States there is usually no such limitation. Temporal caps for breach of covenants were not provided in 51% of the Indian transactions reviewed and are not common in U.S. transactions. However, 41% of the Indian transactions reviewed included a temporal cap between zero and four years. In terms of value caps, 76% of the Indian transactions reviewed had liability associated with breach of covenants limited to between 80 - 100% of the purchase consideration, whereas only 9% of U.S. transactions reviewed had such a cap.

**Disclosures:** Ninety-one percent of the Indian transactions reviewed did not include a data room as a general disclosure, and such general disclosure is not common in U.S. transactions. Similarly, 89% of the Indian transactions reviewed did not include diligence reports (whether vendor or investor diligence reports) as disclosures, and such disclosures are also not common in U.S. transactions. Continuing this trend, 85% of the Indian transactions reviewed did not include public records as a disclosure, whereas such disclosures are common in U.S. public company transactions. In contrast to other forms of general disclosures, audited accounts were accepted as general disclosures in 24% of the Indian transactions reviewed, but such general disclosures are not common in U.S. transactions.

**De minimis and basket:** From among the Indian transactions reviewed, 55% and 52% of the transactions had basket and de minimis thresholds, respectively, for indemnity claims as compared to 81% - 89% and 24% - 27%, respectively, for U.S. transactions. Notably, in all Indian transactions under review that included baskets, only 20% - 38% of U.S. transactions under review included baskets, these baskets were structured as tipping baskets, rather than as deductibles. Seventy-seven percent of the Indian basket thresholds and 56% - 62% of U.S. basket thresholds were below 0.5% of the consideration.

**Material adverse change (MAC):** MAC constructs continue to be included in a substantial number of Indian and U.S. transactions, with 73% of the Indian transactions and 95% of the U.S. transactions reviewed including similar provisions. However, only 13% of the Indian transactions and 1% of the U.S. transactions reviewed had objective thresholds for determining MACs.

**Governing law and dispute resolution:** On expected lines, 87% of the Indian transactions were governed by Indian laws and substantially all of the U.S. transactions are governed by U.S. laws. Nearly all (96%) of the Indian transactions had arbitration as one of their dispute resolution mechanisms as compared to only 6% - 17% of U.S. transactions. The Singapore International Arbitration Centre (SIAC) remains the preferred institution outside of India for administering arbitration in Indian transactions, with 62% of such Indian transactions reviewed with SIAC arbitration. After Indian cities, Singapore was second in terms of venue and seat for arbitration proceedings from among the transactions reviewed with arbitration.

## Conclusion

The burgeoning economic potential of India presents investors based in the United States with significant opportunities and also does so for Indian businesses seeking to expand their global footprint in the United States. This, coupled with a more stable legal framework that we have been seeing for investments between the two countries, only accentuates the growth viability factor. As both nations continue to navigate evolving market and regulatory dynamics, and with liberalization efforts in India over the last few years, a deep understanding of the legal and commercial considerations would aid dealmaking.

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