

INTERVIEW

CROSS- BORDER M&A IN INDIA POST COVID-19



Interviewee: Mr. Ambuj Sonal (Associate Partner at Link Legal)

Brief Introduction of the Interviewee:

Ambuj has completed his BA LLB (Hons.) from Chanakya National Law University in the year 2012 and is a member of the Maharashtra and Goa Bar Council. Ambuj started his professional career as a transactional and general corporate lawyer. His prime area of practice includes mergers and acquisitions, strategic alliance, real estate transactions, cross border transactions, joint ventures and private equity.

Ambuj has extensive experience in advising on structuring and acquisition of companies by foreign investors, brand acquisitions, real estate transactions, and assisting clients on business related compliances for entities engaged in various sectors, including pharmacy, logistics, warehousing amongst others. Apart from this Ambuj has keen interest in dispute resolution and has represented clients in domestic and foreign seated arbitrations including proceedings held at Singapore International Arbitration Centre (SIAC). Ambuj's articles on legal subjects have been published on various media platforms and reputed journals such as moneycontrol, CNBC, Business World Legal, Live Law, Mondaq and Criminal Law Journal. Ambuj has recently been named as one of the top lawyers in India by Forbes India.

Ambuj has an illustrious working experience and has previously worked with DH Law Associates, Lodha Group of Companies, Pioneer Legal and is currently Associate Partner in the M&A and Private Equity Practice at Link Legal, Mumbai.

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Q1: A number of restrictions were placed globally, for instance, Canada announced advanced scrutiny of foreign direct investment of any value, controlling or non-controlling in Canadian businesses related to public health and goods/services supply. Similarly, the European Commission released a guidance note highlighting the potential risk to strategic industries and noted the need to balance foreign investment with appropriate screening tools like prior approval or imposition of investment conditions. Accordingly, several European countries, like Germany, France, etc. announced changes in this regard. How did such regulatory change impact cross-border M&A?

As Covid 19 had impacted all businesses globally, there were ample of possibilities of the bigger players acquiring the mid-size/smaller players at a rate which was substantially discounted, considering the need of funds and requirement of meeting the obvious increase in expenses of such organizations. The primary reasons for implementing additional scrutiny in relation to foreign investment proposals by several countries, including Canada and European countries, was to control the misuse of the uncertain situation and opportunistic investment behavior. Certainly, any investor analyses the ease of doing business while approaching any cross-border acquisition. If the foreign investment regulations of the target's country are not smooth or tightened, the investors would tend to take a step backwards. This has indeed impacted the foreign investment flows. For example, the European Commission Report on foreign investment flows (released in November 2021) suggests that the FDI flow in European Countries have declined by approximately 71% during Covid times. While the governmental authorities of these countries had increased scrutiny on inbound foreign investments for ensuring that new risks on their economy or national security are avoided by regulating the opportunistic takeovers, this has resulted in a major impact on FDI flows which has directly affected the economy. Similar measures were also introduced by the Indian government by way of notifying press note 3 in 2020 which required that all investments from entities with which India shares a land border, will have to be made under the 'approval route' and will require security clearance. Post this notification, the Indian Government has not provided any approval for investments proposed by China, which was a major investor during pre-covid times. Given such approval route, the investors from China are reluctant in proposing any acquisitions in India, which obviously has adverse impact on the cross-border M&As from such countries.

Q2: The Material Adverse Changes Clause became a much talked about concept as a result of the pandemic. In international jurisprudence, there have been a number of cases wherein such a clause has not been of much help owing to how it has been phrased. Has there been a shift to reliance and acceptability of such clauses post the Covid-19 pandemic?

The Material Adverse Change (MAC), also known as Material Adverse Effect (MAE) clauses under any acquisition agreement would ideally mean that in case of occurrence of MAC, during the period between signing of the contract till closing, the buyer will have the right to cancel the contract or to renegotiate the same. There were lot of discussions around MAC provisions during COVID times (more particularly in earn-out structures) as the same could possibly be considered as a MAC event. That said, the entire interpretation of a MAC clause depends on how such clause has been constructed under a particular contract. Some of the MAC clauses would specifically cover situations beyond control of the parties which

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results in financial loss to the target company, others may simply list out certain events which would 'materially' impact the business of the target such as, business discontinuity, regulatory actions, inability to conduct business, etc. In my experience, I have seen some buyers contemplating to invoke the MAC provisions and withdraw from the deal, however, mostly such matters have been commercially settled. Post COVID -19, the buyers and sellers have been considerate about MAC provisions under their contract and the parties have now focused on drafting MAC provisions more carefully in order to avoid any ambiguities of its applicability.

Q3: Similar to the Material Adverse Changes Clause, the Force Majeure clause was also much discussed in light of the pandemic. Do you think having this clause in the transaction documents in cross-border M&A transactions is of help? If so, are there some specific requirements that the drafters of the transaction documents must keep in mind to ensure that the Force Majeure clause helps the clients in the pandemic situation?

The outbreak of COVID-19 is a peculiar instance which probably no one would have considered while drafting a MAC or a force majeure clause. Under transaction documents of a cross-border M&A deal, a MAC provision would suffice the purpose and also cover the force majeure provisions, if properly constructed. These provisions are helpful under such documents as they provide a buyer an option to walk away in case any adverse impact is caused to the target. Post COVID, the parties to such transaction documents have adopted a safer approach to define MAC or force majeure under the contract in a manner which is more detailed, and all ambiguities are avoided. More particularly, the MAC or the force majeure provisions are now drafted in detail to include the factors like - (i) defining the 'materiality'; (ii) a threshold of financial loss; (iii) set parameters for determining the impact on target of the MAC event; (iv) burden of proof; and (iv) the commercial objective of having MAC or the force majeure. In some cases, parties have also agreed that a MAC event or a force majeure event, does not automatically trigger the termination right of the buyer, rather the sellers would prefer to have a specific cure period against each MAC or force majeure event. The idea is to draft the MAC or force majeure clauses in a manner which avoids any confusion as to what events are covered, what impact would result in a deal to fall through and what are the recourses each party would be entitled to.

Q4: Industries such as aviation, hospitality, and tourism saw a lot of uncertainty during the lockdown. While the recovery post lockdown has been noticeable, such industries still saw considerable impact. How did such uncertainty affect the cross-border M&A activities in such sectors and what impact did it have on the transactions?

Given that these sectors are considered as the backbone of any developing countries, the governments, in various jurisdictions had rolled out multiple schemes to support these industries. For example, Indian Government had announced the Emergency Credit Line Guarantee Schemes (ECLGS), Service Exports from India Scheme (SEIS), Loan Guarantee Scheme for Covid Affected Tourism Service Sector (LGSCATSS), etc. Insofar as the M&A activities are concerned, the FDI in these sectors had less attraction compared to other sectors such as tech (Fintech, Edtech, Healthtech, etc.), infrastructure, computer

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software and hardware, trading, etc. In India, these sectors accounted for the least FDI in the year 2021 which shows that investors are still focusing on tech and infrastructure sectors more than any other businesses. While the schemes launched by the government may be useful in revival of these sectors post COVID, the M&A in these businesses would require more attention and probably the government would need to roll out certain relaxation under its FDI policy in relation to these sectors.

Q5: This ongoing pandemic is enlightening people on how health problems can destroy and paralyze the economic system. As such, society is reminded of the importance of resolving existing environmental issues. This leads to the demand for new green technologies which requires the transfer of technology from developed to developing countries like India. In this sense, what are your views regarding the post-COVID-19 era, where it is expected that M&A deals will be actively accomplished in target countries that are highly developed in the innovation index, particularly in green technologies (which is in line with the zeitgeist of the post-COVID-19 era and requires nature and society to coexist as a whole)? Would this have specific legal implications?

The thrust towards the climate consciousness can be seen across the world and India is no exception. Insofar as M&A activities are concerned, renewable energy sector has seen significant growth as this sector has accounted for almost USD 10 Billion investment in 2021 as compared to approximately USD 2 Billion between 2016-20. Recently, the Finance Minister of India has announced the issuance of sovereign green bonds which is supposed to provide the sufficient pool of funds in India that is required to finance the climate resilient infrastructure, lower carbon emission and transportation, also paving ways for new, green and clean technologies in the Indian market. The introduction of such green technologies would further provide a boom to the cross-border M&A in India. There are quite a few funds globally which are dedicated to support and fund the businesses which are working towards climate change. Green technologies requires innovation and there is a need to protect the patent of such technologies and their trade secrets. While the patent authorities of developed countries have introduced a robust mechanism for protection of the innovations involving green technologies by way of introducing the registrations of Green Intellectual Property, India is yet to develop such protections. Once India becomes a hot destination for cross-border M&A in green technologies, the Indian government would need to have in place a mechanism to protect the intellectual property rights relating to green technologies.

Q6: The cross-border movement of capital has suffered due to the COVID-19 pandemic since December 2019. According to the empirical evidence, COVID-19 indices do not hamper M&A deals in general. This indicates that the managerial capabilities, not the outbreak itself, determine locational decisions of M&A deals during the pandemic. In this vein, can we probably expect that the vaccination rate will become a key factor of locational decisions for M&A deals in near future? Would this have any effect on the Indian M&A transactions?

The pandemic initially caused a major fall in cross-borders M&A (both by value and volume), as the trades suffered due to uncertainty, unpreparedness, lack of clarity on prohibitions and cost-reductions. However, in 2021 the cross-border M&A deals have shown significant development, more particularly in the Asia Pacific region. The COVID outbreak also emerged as an opportunity for bigger multinational

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groups to acquire the smaller groups in the developing countries. This led to the framework of restrictions imposed by various countries on opportunistic takeovers. A good vaccination rate will obviously provide a comfort to the investors for investing in targets situated at locations having better rate of vaccination as it provides a smoother operational advantage. However, the business projections, expansion in a particular market and acquisition of clients of competitors remains the primary objective for acquisition deals.

In India, the FDI has tremendously increased in 2021 irrespective of the vaccination rates. In any event, India has a very healthy vaccination rate which adds up to the interest of the foreign investors.

Q7: The pandemic has changed the perspectives of many people on sustainability, technology, CSR etc. As such, how did Covid-19 impact the due diligence carried out in cross-border M&A transactions?

It has been noticed that the concern over environmental, sustainability, technology, CSR compliances have increased after the COVID. For example, post COVID, ESG compliance is already gaining traction and has become a key aspect while making any investment decision especially in the context of cross-border M&A. The investors have approached the due diligence by setting a specific ESG Criteria. ESG investing is also referred as sustainable investment or impact investment or socially responsible investment. In addition to the environmental concerns, under the ESG criteria, the diligence is undertaken on the target to examine how the target manages its relationships with employees, vendors and the overall community where the business is being operated. This would include the CSR activities undertaken by the target. The ESG compliance is now seen as a major factor which effects the valuation of a target company and is also being scrutinized specially while undertaking a due diligence on targets. The laws relating to ESG are interspersed under various statutes and there is currently no need of a specific legislations in this regard, however, the investors are insisting on specific warranties relating to ESG compliances under the transaction documents.