Title- CROSS BORDER MERGERS AND ACQUISITIONS: A CRITICAL STUDY

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DECLARATION

I, the undersigned bearing roll no. 20ML021 do hereby declare that the work in the dissertation titled ***"Cross Border Mergers And Acquisitions: A Critical Study"*** has been carried out by me and submitted in partial fulfilment of the LLM degree in Criminal and security law in the Institute of Law, Nirma University under the guidance of Asst. Professor, **Nirbhaya Kumar Indrayan**.

I further declare that all the work in this dissertation represents my ideas in my own words and where ideas of others are taken I have cited their original source. I have not copied or fabricated anything in this final report and do hereby declare that the whole dissertation is my own work and neither nor any part of the said dissertation is published anywhere.

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For My Parent

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- Securities Act of 1933 (United States)
- Securities and Exchange Board of India Act, 1992
- The Companies Act, 1956
- The Competition Act, 2002
- The Income Tax Act, 1961
- The Indian Stamp Act, 1899

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- M&A Mergers and Acquisitions
- MRTP Monopolies and Restrictive Trade Practices Act
- CA Competition Act
- ECB External Commercial Borrowing
- FII Foreign Institutional Investor
- FSA Financial Services Authority
- LLC Limited Liability Company
- LP Limited Partnership
- RBI Reserve Bank of India
- SEBI Securities & Exchange Board of India
- SEC Securities & Exchange Commission
- UCITS Undertakings for Collective Investment in Transferable Securities
- UK United Kingdom
- USA United States of America

CHAPTER1

INTRODUCTION

1.1 Introduction

In the current scenario mergers and acquisitions have become the focus in the growth strategy of organizations. As markets are maturing in developed and developing economies, mergers and acquisitions seem to be a big attraction for the minds of the top businessmen. Since 1991, the cycle of progression, privatization and globalization started by the govt. has affected the working and administration of Indian corporate undertaking. To endure and fill in the powerful business climate, Indian ventures are pulling together their methodologies. During the time spent pulling together, consolidations and acquisitions are becoming ordinary wonder. Consolidations and acquisitions are not new in the Indian economy.

Companies utilized M&A to grow in the past as well. More time has changed for M&A's purposes. Indian companies are now redirecting themselves to the areas of core competency, market proportion, global competitiveness and consolidation as they spread their wings indiscriminately throughout licensing and licensing days. The foreign competitors arrived at this refocusing procedure. This naturally needs organizations to grow and expand into well-understood businesses. Leading companies have thus attempted restructuring to build a tremendous presence in their main fields of interest. The M&A is an effective way to restructure companies and therefore an essential component of a company's long-term business plan[1].

1.2 Research Objective

The effect of this study is to analyze about Cross- Border Mergers and Acquisitions and its impact on Indian economy as well as on the world economy. This study will also primarily focus on the various laws related to Cross- Border mergers and Acquisitions in different countries of the world including India's legal aspects of the Cross-Border Mergers and Acquisitions also analyzed.

Further this study will focus upon different and some new facts about the Cross-Border Mergers and Acquisitions and the role played for the development of a countries economy.

1.3 Research Methodology

The focus of this study is on the phenomenon of hate crimes in Indian society. As the study's title suggests, it is concerned with the rise in hate crimes and, as a result, their effects on people's human rights. This is a qualitative study that focuses on the relationship of various constitutionally protected factors with the people, such as religion, sex, gender, occupation, equality, and so on. It explores how and why hate crimes are perpetrated against these protected groups, as well as what function these crimes are meant to serve.

As a result, data from secondary sources such as newspapers, surveys, and electronic websites were used to fully comprehend the issue of hate crimes. Furthermore, in order to assess its effect on the current system of human rights and legislation, the analysis employs the doctrinal method to learn about all of the rights that are being impacted, as well as to comprehend the true meaning of the current law—whether it is capable of addressing the issue. In order to understand the problem, both primary (legislations, case-laws, etc.) and secondary (scholarly documents, studies, etc.) data are considered.

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[1] V.K.Puri, "Corporate Mergers & Acquisitions", 2nd ed. 2008, p. 1.

Last yet not the least, a ton of material for the finish of this task was given by the staff counselors and their sources of info were important for the appearance of this undertaking.

1.4. Research Questions

The basic research questions sought to be tested through this study are;

i. What do you mean by Cross- Border Mergers and Acquisitions and is there any law in this regard?

ii. What are the Cross- Border Mergers and Acquisitions laws of different countries of the world?

iii. What are the similarities and differences between Indian Cross-Border Mergers and Acquisitions laws and other countries laws?

iv. What is the position of India in Cross Border Mergers and Acquisition Market and what strategies have to be adopted for the improvement of Cross-Border Mergers and Acquisitions market?

v. What are the laws relating to settlement of disputes in Cross-Border mergers and Acquisitions?

vi. What is the position of India in compare to People republic of China regarding Cross-Border mergers and Acquisitions laws?

vii. Is Indian Mergers and Acquisition laws are ambiguous?

viii. What are the provisions in the competition law of India regarding Cross Border Mergers and Acquisitions?

ix. What are the provisions in the competition law of other countries and what India have to learn from those laws?

x. Is India ready to change its Cross-Border Mergers and Acquisition laws?

1.5 Research Hypothesis

- Even though company law, SEBI and Competition law regulates mergers. But these laws are not adequate to regulate Cross-Border Mergers and Acquisitions.

- The actions of adequate restrictions on the size and volume of business is encouraging enterprises to opt for Mergers and Amalgamations.

- In the era of globalization and liberalization the principles of corporate law are not adequate to regulate particularly Cross-Border Mergers and Acquisitions.

- The legal provisions relating to income tax and other taxes are not adequate and effective to control or manage the Cross-Border Mergers and Acquisitions.

1.6 Research Scheme

Chapter I deals with the Introduction to the paper and the topic. This chapter basically explains the research questions framed, methodology to be adopted for study and also the scheme of the study. It contains a basic account of the whole project.

Chapter II provides an overview of the whole process of Cross-Border Mergers and Acquisitions and its legal framework according to the changing globalized world. It also describes some of the actors who play a vital role in Mergers and Acquisition market. It involves the rules relating to the international perspective of mergers and acquisitions.

Chapter III tests as to what are the kind of Cross-Border mergers and Acquisition laws in different countries of the world and what India's position in this regard. In this chapter researcher also tries compare Indian mergers laws with the China's mergers law.

Chapter IV titled "Settlement of disputes in Cross-Border Mergers and Acquisition" deals with the whole concept of dispute resolution in Mergers

transactions and multi-step resolution clauses with examples. It also contains practical considerations affecting arbitration in Cross-Border Mergers and arbitrability of Cross-Border Mergers and Acquisition disputes.

Chapter V involves the comparative study of different countries in regard to the competition policies relating to the mergers and acquisitions. It includes the competition policies of U.K, U.S and India.

Chapter VI contains the conclusions and suggestions. This chapter would attempt to answer the research questions framed based on the research and the data collected therein. The chapter will also contain some suggestions and critical analysis of the concept of 'Cross-Border Mergers and Acquisitions' and their impact on global economy. It will look at the relation of Mergers and Acquisition and economy of a country.

CHAPTER2

CROSS BORDER MERGERS AND ACQUISITIONS: LEGAL FRAMEWORK IN INTERNATIONAL PERSPECTIVE

3.1 Introduction

M&As have long an essential strategy to grow overseas for cross-border mergers and acquisitions. In the past two decades, M&As have grown rapidly due to technical advances and globalization. It rose rapidly in 2001 and 2002, and rebounded again in 2003 as new changes were emerging in the world economy in the 1990s, with the booming stock markets and a higher degree of financial deregulation worldwide. Traditionally, the most important acquirers and target states of M&As have been industrialized nations, namely the European Union (EU15) and the United States. During the 2003–2005 years, 85 percent of USD 465 billion cross-border M&As, 47 percent of which and 23 percent belong either as purchasers or as target countries, respectively, to developed nations (UNCTAD (2006)).

3.2 Mergers and Acquisitions in a Globalized World

National and regional markets for mergers and acquisitions (M&As) expanded till 2000, reaching an estimated volume of 2,800 billion euros world-wide in 1999, with a European market of 1,200 billion.[32] Germany has become the biggest M&A market in Europe.[33] These markets are increasingly linked to each

[32] Counting only the value of target companies. The figures are provided by Securities Data Corporation: Frankfurter Allgemeine, 12 November 1999, p. 25.

[33] Germany has had a M&A transaction volume of 500 billion euros in 1999. Bohmert, Borsenzeitung, 12 February 2000, p. 9.

other through cross-border transactions. Some of them involve large corporations with significant shares in the world market. For example, the Dasa/Aerospatiale (1999) merger resulted in the third largest air and space enterprise in the world; the Warner/AOL merger (January 2000) in the largest combined media and internet access service; the merger of Vodafone/ Mannesmann (March 2000) in the largest world-wide telecommunication enterprise and the fourth largest enterprise in the world; and the BP/Amoco merger (1998) in the largest British company and one of the three largest oil companies in the world.[34]

Cross-border M&As, in particular those involving large listed corporations, are a salient feature of economic globalization.[35] Global communication and transport, financial flows and financial markets favor external growth through M&As and the consolidation of business interests in markets with over-capacity. Some M&As are seen as an economic necessity, others as a large economic opportunity to exploit the potential benefits of the economies of scale, joint product development and manufacturing, combined purchasing or selling, or other synergies. Some cross-border mergers and acquisitions are executed for the simple fact that they are feasible. Not surprisingly, many national and international M&As result in failure, as evidenced by the traumatic divestment of Rover (Great Britain) by BMW (Germany) in March 2000.[36] There are indications that in many cases, the strategic benefits of a merger are not necessarily the strongest motivation behind the transaction. The flow of foreign

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[34] Frankfurter Allgemeine, 15 October 1999, p. 1 (Dasa/Aerospatiale); Frankfurter Allgemeine, 11 January 2000, pp.1, 13, 18 (Warner/AOL); Frankfurter Allgemeine, 5 February 2000, p. 13 (Vodafone/ Mannesmann); Amoco *Proxy Statement* (30 October 1998).

[35] Newman/di Chicco, 'Strategic Choices' in: BenDaniel/Rosenblum (ed.), *International Mergers and Acquisitions, Joint Ventures and Beyond* (1998) pp. 3-25. For critical comments on the impact of globalization on the developing countries, see UNCTAD Annual Report 1999.

[36] Financial Times, 16 March 2000, at pp. 1 and 8.

direct investment is significantly influenced by key variables of US and other capital markets, such as bond yields, exchange rates, and stock prices.[37]

If the cross-border merger or acquisition involves listed companies, a clash of different capital market cultures with differing analyst philosophies can frequently be observed. These philosophies greatly influence stock market prices. Since they sometimes reflect future growth potential and at other times present earnings, this often leads to amazing differences in the market capitalization value of corporations.

3.3 The actors in Mergers & Acquisitions Markets

3.3.1 Investment Banks

If we look at the various participants or actors in the M&A markets - *i.e.,* boards of companies, shareholders, and investment banks - the very influential role of investment banks must first be noted. Investment banks constantly carry out market research in order to identify suitable M&A candidates. Then they approach the boards of the potential merger candidates with precise proposals for such transactions. They accompany the deal with their advice, due diligence procedures and financial arrangements. US based investment banks have played the leading role

as market makers and fee collectors.[38]

37 Vasconcellos/Kish, 8 J. Multinat'l Fin. Mgmt., p. 431 et seq. (November 1998).

[38]For the M&A related 1999 investment banking business in Germany, the following ten investment banks played leading roles (percentage of market share is noted in parentheses): 1 st Goldman Sachs (18.2); 2nd Morgan Stanley (15.8); 3rd Merrill Lynch (12.3); 4th CSFB (8.0); 5th Dresdner Kleinwort Benson (7.8); 6th J.P. Morgan (7.5); 7th Lazard (5.9); 8th Rothschild (5.8); 9th Deutsche Bank (4.7); 10th Warburg (3.4). See Bohmert, Borsenzeitung, 12 February 2000, p. 9.

3.3.2 The Boards of Acquiring or Merging Companies

Considering the job of organizations engaged with M&A exchanges, it is the board and not the investors that ordinarily start to lead the pack in the exchange. At the point when it is said that it is the venture banks that search for M&A competitors and along these lines make the market, we ought not neglect the way that in the present warmed air of worldwide M&A fever, the sheets of huge and universally working organizations do their own statistical surveying to distinguish possibility for a procurement or an agreeable or antagonistic dominate. Amazing models can be found in the auto industry and in web diversion and business.[40] If a board wants to acquire another company, it rarely needs to obtain shareholder approval, at least if the transaction is small and does not affect the structure of the acquiring company.41 Even if shareholder approval is required, it is nevertheless the board that at its discretion takes the initial decision to go ahead with the transaction and defines its terms and conditions. Unless a majority of shares in the target company can be bought directly from a parent company or some other majority shareholder, the board of the acquiring company then makes a proposal to the target company board and, as the case may be, to its shareholders. The board of the acquiring company normally negotiates with the board of the target company in order to bring about a friendly take-over or acquisition and to conduct due diligence procedures to assess the target company's financial health and business position.

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[39] See International Herald Tribune, 24 March 2000, pp. 1, 18

[40] On merger discussion between yahoo! And eBay, see Financial Times, 25 March 2000, p.1. see also Warner/AOL, supra note 3.

[41] If such a transaction includes a substantial change in the structure of the economic situation of the company, the board, under German law, would be obliged to ask the consent of the shareholders meeting, following a decision of the federal court in the Holzmuller case: BGHZ 83, 122. Under most US State corporation laws, a minor M&A transaction (a 'whale minnow merger*) does not require shareholder approval, Clark, *Corporate Law (*1986) p. 450.

In a transaction envisioned as a merger among equals, the boards of the companies involved enter into friendly negotiations that aim at bringing about a transaction that serves the interests of both companies and their shareholders in a balanced way. In both a friendly take-over and a merger among equals, the negotiations normally result in a merger agreement or a business combination agreement. This agreement serves as a template for the entire transaction, describing all necessary steps and defining the duties of the boards to cooperate and contribute to the success of the transactions by taking all measures necessary from their side.

3.3.3 The Boards of Target Companies

The board of a target company that is not strong enough to negotiate for a merger among equals is nevertheless not helpless. It can still play a rather influential role in the transaction, since it is the board of the target company that decides whether the proposed take-over will be friendly or hostile and can thus retain a certain degree of leverage even though it is in a weaker negotiating position. It is in the best interests of the bidding company to avoid a hostile take-over contest that would be more expensive, more difficult, and more susceptible to failure than a friendly one. In many cases, the board of a target company may take counter-measures or even make

a counterattack through a take-over bid for the bidding company.[42] The key role of the CEO and the board of the target company in a take-over bid is reflected in the fat compensations frequently earned by them in the deal.

[42] Mutual hostile takeover bids were made by Elf Aquitaine and Total Fina, July 1999; Frankfurter Allgemeine 28 July 1999, p.17.

3.3.4 The Shareholders

The investors of organizations engaged with a consolidation can't generally impact the exchange, despite the fact that they are the legitimate proprietors of the organizations. The leading group of an obtaining organization doesn't really require earlier investor assent for the procurement of another organization. In general, shareholders can influence an M&A transaction in two ways: (a) through voting at a shareholders' meeting in cases where shareholder approval is required by law, e.g., for a statutory merger, under German law, or for a purchase or sale of equity interests, which is substantial in relation to the size of the company; and (b) as individual shareholders by deciding whether or not to accept a take-over bid.

3.3.5 Accounting Firms Due Diligence

Accounting firms play an important role in a merger transaction. They check a target company's background and financial health, which plays a decisive role in determining its price. Each acquisition starts with a thorough due diligence procedure, which is typically carried out on behalf of the seller (a parent company or other major shareholder) in order to fix the selling price and justify it vis a vis the own shareholders or potential (and often competing) buyers. In a hostile take-over bid, such due diligence procedures are not feasible. Bid prices must be calculated on the basis of publicly available data. In a merger among equals, due diligence procedures can sometimes be more restrained for reasons of prestige and diplomatic courtesy. For these and other reasons, mergers among equals have a relatively greater risk potential for shareholders of the participating companies.

3.4 The Role of the Law

Mergers and acquisitions involve complex legal transactions. This complexity is significantly increased when the merger crosses national borders. Remarkably, with the aid of teams of lawyers and investment bankers, there appears to be no real legal obstacle to a swift execution of such transactions, regardless of size or of whether it is a friendly merger or a hostile take-over. The vast majority of the legitimate skill utilized in these exchanges originates from the lawful and monetary act of the US capital market, as the biggest market of this sort on the planet, or from London, still one of the world's driving monetary focuses. If the transaction involves companies from Continental European or South American states, one can observe a different style and wording of documentation, as is typical for civil law countries; however, the legal patterns of the transactions are still very similar.[43]

Lawyers active in cross-border M&A transactions have to cope with a variety of different national company and merger laws, tax laws, anti-trust authorities, and other legal issues. Any legal analysis must take an international perspective, identify conflict avoidance techniques, and harmonize the different applicable laws. In the international M&A business, one can observe an enhanced mutual understanding of different company laws and a harmonization of ideas on corporate governance with regard to internationally operating companies or groups of companies. As lawyers, however, we cannot be content with an

[43] Examples for similarities and diversities can be found in the merger agreement in the BP/Amoco deal (common law style) and the business combination agreement of the Hoechst/Rhone Poulenc deal (civil law style). Both contracts used break-up clauses, the wording of which was much longer in the BP/ Amoco agreement and the fee much higher (1 billion US dollars as compared with 75 million euros in the Hoechst deal).

analysis of the legal tools needed to bring about a cross-border merger or acquisition or with the partial improvement of those tools. It is equally important to identify open problems of legal protection for shareholders, investors, and capital markets in general. Such open problems surface in many areas, particularly in company law, capital market law, and anti-trust law.

3.5 International Company and Merger law

3.5.1 The Recognition of Foreign Companies

The unspoken prerequisite of all legal acts carried out in conjunction with an international merger is the recognition of foreign companies as legal entities in all relevant legal systems. This general principle, however, does not have a uniform international legal basis. It is based on bilateral treaties in public international law.[44] Even within the European Union (EU), no uniform community rules have been established.[45] The recognition of foreign legal entities is predominantly based on national conflict of law rules.[46] In 1999, however, the European Court of Justice (ECJ) significantly limited the application of national conflict of law rules in the *Centres* decision, based on the Freedom of Establishment principle of Articles 43 and 48 of the Treaty of the European Union (TEU). Through this decision, the ECJ facilitated the recognition of foreign legal entities from Member States within the EU.

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[44] E.g., Art 25(5)(2), Treaty of Friendship, Commerce, and Navigation of 29 October 1954 between the Federal Republic of Germany and the United States of America, BGB1. II1956,488.

[45] EC Treaty on the Mutual Recognition of Companies and Juristic Persons of 29 February 1968 (BGB1. II
1972, 370) has never come into force for lack of ratification by the Netherlands.

[46] ECJ, Decision of 27 September 1988 (Rs C81/87), 1988 Collection, 54, 84; see also RIW 1989, 304; NJW1989, 2186 (Daily Mail).

Many states currently recognize the principle that the host state has a right to make the foreign company operating in the host state subject to its laws to the extent necessary to protect shareholders, other investors, and creditors if the law governing the foreign company does not provide them with sufficient protection. Following the *Western Airlines* case in California, this principle has been well established in the corporate laws of California and New York. Similarly, the *Centres* decision of the ECJ points in the same direction. It is fair to say that at present, the law 'governing' a foreign company in a host state, be it under the incorporation theory or the seat theory, relates only to the company's establishment and organizational rules. Other questions such as disclosure requirements or liability are governed by the laws of the host state.

3.5.2 German Conflict of Laws Rules

According to German private international law, the law applicable to companies is determined according to the 'seat theory', where 'seat' refers to the location of a company's headquarters. A minority opinion in German private international law considers the intent of the founder expressed in the act of incorporation as decisive ('incorporation theory'). However, the seat theory is still dominant among EU member states. Within the EU, the incorporation theory is applicable in Great Britain, and in a limited form in Denmark and Italy.[47]

For legal questions concerning the parent-subsidiary relationship within transnational groups of companies, German private international law makes the company law of the subsidiary (the 'controlled' company) applicable. However, for

[47] For England, see Collins (ed.), Dicey & Morris, *The Conflict of Laws,* pp. f 112-13; for Denmark, seeWerlauff, ZIP 1999, 867; for Italy, see Staudinger/Grofifeld, para. 154.

questions of the internal structure of the parent company and its decision-making process, the law to which the dominant company is subject applies. This was particularly stressed by the German Federal Court *(Bundesgerichtshof)* in the *Holzmuller* case, taking into account the protection of minority shareholders of the parent company.[48]

According to German private international law, the laws applicable to all companies participating in a merger are cumulatively applicable ('unification or cumulation theory'). According to the majority legal opinion on the German Company Law *(Aktiengesetz;* AktG), a German company may not merge with a non-German company. The merger of a foreign company into a German company is, according to majority German legal opinion, prohibited by the German *Umwandlungsgesetz* (UmwG; Law Regulating the Transformation of Companies).However, critics of this opinion argue that the UmwG does not contain rules applicable to international cases. A compelling argument brought by critics of the majority opinion is that German law must orient itself towards the Freedom of Establishment principle of Articles 43 and 48 EU Treaty. This argument is supported by the ECJ's *Centres* decision.

The prevailing German legal doctrine also considers the merger of a German company into a foreign company to be prohibited. Such a merger is seen as transferring the company's seat out of Germany. As the seat theory, which is still applicable in German international company law, makes a company subject to the laws of the jurisdiction where it has its seat, the transfer of a company's seat through a merger results in liquidation. This leads to the realization and taxation of capital gains. However, the opinion supporting the allowability of both the

[48]*See* Staudinger/Grofifeld *supra* note, para. 582

merger of a German company into a foreign company and the merger of a foreign company into a German company is gaining momentum - at least as long as the merger is allowable according to the applicable foreign law (unification theory). This opinion also appears to be supported by the Centres decision.

The state of German law for current international merger practice is still presently too unclear for acquiring or merging companies to take risks in the structuring of a cross-border merger with large economic significance. Therefore, current international merger practice assumes the reality of German legal obstacles to cross-border mergers and avoids them.

3.5.3 US Conflict of Law Rules

The corporate laws of US States follow the incorporation theory. The law applicable to a corporation is the law which the incorporators have chosen in the articles of incorporation. However, State corporate laws are subordinate to US federal securities laws and regulations, the securities laws and regulations of individual states, and to the State corporate law standards, which are essential for the protection of commerce and other public interests. Cross-border mergers are expressly allowed by State corporate laws - in particular, by the corporate law of Delaware - with regard to corporations in other US States as well as non-US companies to the extent that the merger is allowable under the applicable foreign company law (unification theory).[49]

3.6 ACQUISITION OF CORPORATE CONTROL AND STATUTORY MERGER

49 Delaware General Corporation Law art. 252 (a).

3.6.2 The New Shareholders

This does not necessarily mean, however, that the shareholders of the target company were eliminated by the merger transaction. Their status depends on the take-over or merger conditions, as denned either in the take-over bid or in a merger agreement. Often, the investors of the objective organization get cash in thought for their offers, just like the case in the Deutsche Bank/Bankers Trust deal.50 interestingly, if the assume control over bid accommodates a trade of target organization shares against those of the obtaining organization, the objective organization investors become investors of the gaining organization (parent organization). Many assume control over offers contain these proposals for thought in kind, that is, shares in the securing organization, similar to the case in the Vodafone/Mannesmann assume control over bid. In a consolidation among approaches, the investors of the partaking organizations should similarly become investors of the enduring organization or gathering of organizations to meet the necessities for a 'joining of interests'. This was the situation in the Daimler/Chrysler and in the Hoechst-Rhone-Poulenc consolidations.

3.6.3 Statutory Merger

These obtaining situations can be trailed by a subsequent advance, a legal consolidation, to shape one solidified organization. For different reasons, such a stage isn't constantly taken. It very well might be financially more attractive to stay with the obtained as a different substance, with its own market position and kindness as a feature of an organized gathering of organizations. The securing organization in any case keeps up with the capacity to coordinate the obtained organization based on corporate control. In the case of the merger between Bankers Trust and Deutsche Bank, a statutory merger would have been difficult or impossible because of the legal obstacles under German law discussed above.

Moreover, the continuing use of the name, market position, and prestige of Bankers Trust was apparently an economically attractive path for Deutsche Bank as the parent company.

In other cases, a statutory merger is desirable. This applies, in particular, to mergers among equals in order to bring about a homogenous, uniform corporate structure. The obstacles in German merger law, however, do not allow such a solution in cases where a German company participates in the transaction, as in the Daimler/Chrysler and the Hoechst/Rhone-Poulenc deals.

The Hoechst/Rhone-Poulenc deal was confronted with the same German legal obstacles to a merger. The German company, Hoechst, could not be merged into the French company, renamed Aventis, because this would have been a cross-border merger out of Germany. It would have led to the liquidation of Hoechst and a taxation of its capital gains. Consequently, Hoechst remained a subsidiary.

[50]See Proxy Statement of Bankers Trust Corp. of 23 March 1999, pp. 1, 20, and A-2.

3.7 The Acquisition of 100 Percent of the Shares: Squeezing out Schemes

A public take-over bid does not necessarily lead to an acquisition of 100 percent of the shares of the target company. However, under the German Law Regulating the Transformation of Companies *(Umwandlungsgesetz;* UmwG), 100 percent can be obtained through a statutory merger (art. 20(1), no. 1 UmwG). The statutory merger must be approved by a 3/4 majority of the capital represented at the shareholders' meetings (art. 65(1), sentence 1 UmwG). Through such a statutory merger, the dissenting shareholders are not squeezed out but they too become shareholders of the surviving company (art. 20(1) no. 3 sentence 1 UmwG).

Under a number of US State corporate laws, a merger agreement can provide that all shares of the target company, including those of dissenting shareholders, will either be converted into shares of the acquiring company or purchased against cash. The merger agreement must be approved by a majority vote at a shareholders' meeting, sometimes with a simple majority (Delaware)[51] and other times with a 2/3 majority (New York)[52] of the shares entitled to vote. In US capital market practice, the merger (in a broader sense) is normally carried out with the aid of a financial vehicle (a 'merger sub'), which is typically a subsidiary of the acquiring company. The merger sub is then infused by the acquiring company with its shares, which are eventually exchanged against shares of the target company. Subsequently, the target company is merged into the merger sub (forward triangular merger) or the merger sub is merged into the target company (reverse triangular merger).[53]

[51] Gilson/Black, *The Law and Finance of Corporate Acquisitions* (2d. ed. 1995) at p. 642, *et seq.*
[52] New York Business Corporation Law art. 903; Gilson/Black, supra note 47, p. 668, *et seq.*
[53] On both techniques, *see* Gilson/Black, *supra* note 47, p. 668, *et seq.*

Triangular mergers can have several advantages. They can simplify a stock exchange and ensure that the target company becomes a subsidiary of the acquiring company. Moreover, triangular mergers ensure that 100 percent of the target company's shares are acquired, since even dissenting shareholders must surrender their shares. In the case of Daimler/Chrysler, it was impossible to infuse a German or US merger vehicle with shares of the acquiring company to carry out the stock exchange because under German corporate law (art. 71d, sentence 2 AktG) the infusion of a subsidiary with shares of the parent company is not allowed.[54] In order to carry out a share exchange, a trustee must be appointed. Nevertheless, a US merger sub was created in order to also aquire the remaining shares of Chrysler shareholders who did not voluntarily take part in the share exchange.

In connection with the merger, attempts by shareholders to obtain a more favorable exchange rate can be reduced and, under US law, completely eliminated. Similarly, the appraisal rights of dissenting shareholders can be extensively reduced.

In Germany, there are good reasons to get as many shares as possible on a voluntary basis through a take-over bid before the formal resolution on a German statutory merger is adopted at a shareholders' meeting. Under German law (art. 15 UmwG), shareholders can contest the bid price in court, even if they voted for the merger. Such rights, however, are excluded if the shares have been traded in for the proposed price before the adoption of the resolution. In the Daimler/Chrysler deal, this strategy was used for the exchange of Daimler shares against the new DaimlerChrysler shares. The business combination agreement set forth as a

[54] Baums, JITE 155 (1999) No. 1, pp. 119, 123.

prerequisite to the transaction that at least 80 percent of the Daimler shares be voluntarily offered to the bidder (DaimlerChrysler). Eventually, 98 percent of the shares were exchanged this way. Any other strategy would have resulted in the possibility that all new German shareholders of DaimlerChrysler would have been able to contest the price in court. This would have been unacceptable for both the Chrysler shareholders and the SEC.

3.8 Merger and Business Combination Agreements

Mergers, in the broad sense of the word, can be carried out without the conclusion of any contract between the 'merging' parties. Two companies may be de facto 'merged' through the simple acquisition by a 'parent' company of a controlling majority of shares. However, a merger agreement is required for a statutory merger (merger in the narrower sense) under German law and under US State corporate laws. In international M&A transactions, merger agreements are normally used only with respect to mergers that are confined to one jurisdiction. For example, in the Daimler/ Chrysler deal, two merger agreements were used, one for the German merger of Daimler AG into DaimlerChrysler AG and another for the US merger of the merger sub into Chrysler Corporation. The Deutsche Bank/Bankers Trust deal also employed a statutory merger confined to the jurisdiction of New York, that is, the merger of the merger sub into Bankers Trust.

Cross-border acquisitions or mergers in the broad sense may be based on a formal merger agreement or executed without such a document. In the latter case, however, an internal memorandum of understanding that outlines the acquiring company's future business policy is often used, even in the case of a unilateral take-

over. The memorandum of understanding is usually intended to help win the confidence of the target company's senior staff.

In the case of a merger among equals, a business combination agreement is used that defines the procedure to be followed and the goals of 'uniting' the interests of the management and shareholders of both companies. The business combination agreement serves as the master agreement for the whole transaction and defines its scope, including subordinate mergers and the duties of the participating companies' boards to cooperate and to do everything in their power to ensure the success of the merger. The agreement is binding upon the participating companies, to the extent that a board is empowered to bind its company. Those parts of the agreement that deal with areas that would require approval at a shareholders' meetings cannot be set forth by the boards as obligations, as these would, of course, be ultra vires acts. They are, therefore, mentioned in the agreement only as conditions, not as obligations. In the Daimler/Chrysler deal, the parties to the agreement were not only DaimlerBenz AG and Chrysler Corporation, but also the newly formed, future parent company, DaimlerChrysler AG.

A business combination agreement does not only contain provisions regarding the various steps of the merger (public bidding, shareholders' resolutions, merger agreements, etc.), but also provisions as to the future structure of the newly formed entity. These provisions tend to follow the idea of a merger among equals. The future board of the common parent or holding company should be equally composed of board members from the participating companies. This must, of course, be determined by the competent corporate body, which is not always the board of directors. In case of a German corporation, the competent

corporate body is the supervisory board. Other measures of integration concern double headquarters, as was the case for DaimlerChrysler. The business combination agreement provided for two 'operational' headquarters in Germany and in the United States. Eventually, however, the German headquarter legally became the seat of the corporation. A business combination agreement also sometimes provides for integration committees and/or a working language for the transaction. English was, for example, declared the common working language in both the Daimler-Chrysler and the Hoechst-Rhone-Poulenc deals.

Business combination agreements, under a number of national company laws, require shareholder consent at a shareholders' meeting. This is not the case in Germany, however, since a business combination agreement typically neither constitutes a statutory merger agreement nor provides for an increase of capital. As a result, there is no express German legal requirement that a board resolution on such an agreement be approved by the shareholders at a shareholders' meeting. A decision of the German federal court in the Holzmiiller case, however, made it clear that shareholder consent is needed in all transactions that substantially change the organizational structure and/or economic situation of the company. The impact of the Holzmiiller decision on business combination agreements is not yet fully explored. As a matter of precaution, a shareholders' approval is advisable.

CHAPTER4

CROSS BORDER MERGERS AD ACQUISITIONS: A COMPARATIVE STUDY BETWEEN THE PEOPLE REPUBLIC OF CHINA AND INDIA

4.1 Introduction

The execution of open-entryway strategy in the previous twenty years, especially the proceeding with endeavors of the Chinese government for its entrance into the World Trade Organization ('WTO'), has made the People's Republic of China (TRC) quite possibly the most appealing nations for unfamiliar venture. Since 1993, China has become the biggest beneficiary of unfamiliar direct speculation (FDI) among every one of the agricultural nations and has been second just to the United States on the planet. Unfamiliar financial backers 'at this point don't see China's market as a fascinating interesting sideline, yet see directing business in China as a crucial part of their business system'.

In this unprecedented investment boom, foreign investors have successfully developed their means from manufacturing based joint ventures and trade name based franchises to capital based operation in Chinese market. Since the middle of the 1990s, it has become a trend that many multi-nationals expand their investment

and operations through mergers and acquisitions f'M&As') in China.[57] It has been noted that despite the drop of FDI inflow in recent years, more than an half of 500

[55]For the statistics and analysis of annual FDI inflow into China, see United Nations Conference on Trade and Development ('UNCTAD'), *World Investment Report I998: The Trends and Developments* {New York and Geneva: United Nations, 1998), pp. 202-204. Recently it is reported that China has attracted US$242.4 billion in FDI since 1992, including 45,000 enterprises operated by multinationals of the *Fortune 500* in China. Yong Wang, 'China's Domestic WTO Debate'(January-February 2000) The China Business Review, p. 54..

[56]W.H. Miller, 'China Boom: This Time It's for Real' (1 November 1993) Industrial Week, p. 45.

[57]See the report in *China Economic ews,* 3 January 2000, pp. 6-7.

largest multinational companies have aggressively developed their investment projects in China with a view to occupy this huge market[58] and M&As are becoming more important as a mode of entering for FDI in Asia.[59] Given the dynamic trend of internationalization of the world economy, one may consider what has happened in China as just the spilling of the global spree of M&As.[60]

Meanwhile, the campaign to establish a market-centered economy in China since 1992[61]has provided an opportunity for domestic government officials, businessmen and practitioners to learn and practice M&As as important means to restructure the national economy. Since the first merger case in the PRC history was reported in 1988,[62] the enthusiasm to employ the strategy soon spread. The training was additionally embraced by the fifteenth National Conference of the Communist Party where the retreat was produced using the old communist philosophy of inflexible public possession. As per Mr. Jiang Zemin, the Secretary General of the Party, any functional and administrative implies that reflect social creation laws, including those of free enterprise, can be strongly utilized. Additionally, resource re-association and

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[58]Gao Guanjiang, Guanyu Waishang Qiangzhan Zhongguo Shichang Wenti ji Zhongguo Ying Caiqu de Zhengce, 'Issues of Foreign Companies Grabbing China's Market and Proposed Countermeasures' in: Ma Hong and Liu Zhongyi, *Zhongguo Fazhan Yanjue 97* [China's Development Studies 97] (Development Publishing House, Beijing, 1997), pp 314-315.

[59]*See* UNCTAD, supra note 1, pp. 205-206.

[60] International M&As have grown at a tremendous speed in recent years. The year of 1998 witnessed approximately USS2 trillion worth of M&A activities worldwide as compared with USS465 billion in 1993. *See* M.M. Brown (ed), *Internationa! Mergers and Acquisitions* (Kluwer Law International, the Hague, 1999), pp. 1-4. M&As volume in 1999 worldwide has reached 2800 billion euro. *See* N. Horn, 'Cross-Border Mergers and Acquisitions and the Law: A General Introduction', a paper presented at the Conference on 'Cross-Border Mergers & Acquisitions and the Law' held in Cologne, Germany on April 6-7, 2000, p. 1.

[61]This has been set up as a national goal through an historical constitutional amendment in 1993. *See* Article 7 of the Constitution of China as Amended in 1993.

[62]In a strict sense, it was not a merger governed by the market discipline, but more an arrangement made by the local government to direct one state owned enterprise to take over another deeply troubled by assuming all the latter's debts of RMB420,000. For the details of the merger between Baoding Boiler Plant of Heibei and Baoding Fan Factory, see Dai Chengyuan, Qiye Jianbin zai Zhongguo Da!u Riqu Zengduo 'The Increase of Enterprise Mergers in Mainland China' (29 August 1995) *Huanan Jinji Xinwen* [Economic News of Southern China], p. 12.

M&As are underlined as the vital piece of the new strategy to encourage the reform.63 Fueled with this most loved approach, in 1997 alone more than 2000 takeovers happened nationwide64 and hitherto upwards of 150 property right exchange communities have been set up in China to work with M&A exchanges.[65] A recent survey shows that among over 800 listed companies more than 210 engaged in various M&A transactions in 1998.[66]

As such, some foreign lawyers have observed that 'conditions seem to be ripe in China for significant growth in M&A activity' and further concluded 'the investment landscape in China, together with innovative transaction structures, can be expected to expand to new horizons'.[67] At the same time, some serious problems with the current legal environment and the tension between globalization and the local legal culture in the course of China's entry into WTO have also raised concerns.[68]

This chapter purports to examine the current legal conditions concerning cross-border M&A practice in China. Part 1 analyses the legal framework of M&A in China; Part 2 reviews certain relevant policies and theories; Part 3 discusses some practical concerns; Part 4 highlights the outward investment by Chinese enterprises through M&A in foreign jurisdictions; and Part 5 draws some conclusions.

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[63] The Working Report made by Jiang Zemin at the Conference, *Renmin Rlbao* [People's Daily - Overseas Edition], 23 September 1997.

[10] See the report on *Zhongguo Zhengquan Boo* [China Securities], 23 December 1997, p. 1.

[65] The World Bank; 'China's Management of Enterprise Assets: The State as Shareholder' (The World Bank, Washington, DC, 1997), p. 10

[66] Study Report 1999 on Securities Market in Wu Xiaoqiu (ed), *Jianli Gongzlieng de Shichang Chixu yit Touzizhe Liyi Baohu* [Establishment of A Fair Market Order and Protection of Investors' Interests] (People's University Press, Beijing, 1999), p. 171..

[67] Special Report prepared by M.M. Hickman and B.R. Miller in: Paul Lee (ed): *Mergers & Acquisitions Yearbook 1997 of International Financial Law Review* (Euromoney Publications, London, 1997), pp. 15-18.

[68] Ibid. For recent discussions in this regard, see P.B. Potter, 'China and WTO: Tensions Between Globalized Liberalism and Local Culture' [1999] vol. 32 Canadian Business Law Journal, pp. 440-473; and S. Lubman, 'The Legal and Policy Environment for Foreign Direct Investment in China: Past Accomplishments, Future Uncertainties' in: *Private Investment Abroad* {Matthew Bender & Co., New York, 1998), 3.1-67.

4.2 The Legal Framework Governing CrossBorder M&A in China

In the transitional period from a planned economy to a market economy, the legal framework governing enterprises is pretty complicated. First, there have been two lines of legislation applicable to enterprises based on ownership classification and modern business organizations including company, partnership and sole proprietorship, respectively. Since the state owned enterprises ('SOEs') and foreign investment enterprises ('FIEs') are the players most concerned with cross-border M&As in China, the following discussion will focus on them.

4.2.1 M&As of State Owned Enterprises by Foreign Investment Enterprises

The legislation on SOEs and FIEs represented the legal achievements in the course of the economic reform in 1980s. The former included the Law on Enterprises Owned by Whole People of 1988 (The State Enterprise Law') and the Bankruptcy Law of State Owned Enterprises of 1986. The latter embodied the Sino-Foreign Equity Joint Venture Law of 1979 as amended in 1990, the Sino-Foreign Contractual Joint Venture Law of 1988 and Foreign Wholly Owned Enterprise Law of 1986. All these laws have been supplemented with numerous detailed regulations issued by different government authorities and judicial interpretation of the Supreme People's Court.

Although the State Enterprise Law allows a SOE to obtain its legal person status with business autonomy and independent accountability, the Law does not grant it any ownership of the property concerned, but only entrust certain property to its possession, use and disposition in compliance with the law.[69] In 1993 the Regulations Concerning Supervision and Management of Assets of State Owned

[69] Article 2 of the State Enterprise Law

Enterprises were promulgated by the State Council. Article 5 provides that assets of SOEs shall belong to the State and the State Council shall exercise the ownership rights on behalf of the State. In practice, the State Asset Management Bureau ('the SAME') as the responsible state authority has been in charge of SOE asset supervision.

Given the domination of state ownership since the establishment of the PRC, SOEs have been the major targets of the economic reform and thus, the targets of M&As.

The first regulation in this regard was issued in 1989 entitled the Interim Provisions of Sale of Small Scale State Owned Enterprises ('the Sales Provisions') by the State Commission of Economic System Reform, the Ministry of Finance and the SAMB. Article 2 states that the local branches of the SAMB shall be in charge of any sale of state property rights. According to Article 4, although in principle, all small scale SOEs may be available for sale, the firms put for sale, however, shall mainly be those insolvent or close to bankrupt; those suffering loss for a long time due to poor management; and those to be sold by local governments for the purpose to rationalize their industrial structures. The sale may be made in forms of sale of a entire enterprise as a whole, or sale of asset shares of the target enterprise.

Article 6 stipulates that all business firms, including foreign investment enterprises are entitled to purchase these SOEs. However, Articles 8 through 10 provide a mandatory appraisal procedure of state assets concerned under the principle that state assets shall be prevented from being lost in M&A transactions.

By taking the underdeveloped social insurance scheme in China into account,[70] Article 14 states that retired employees of the SOE to be sold shall be taken care of by the purchaser by either assuming the responsibilities to these retirees by itself; or by funding the pension and other social insurance of the retirees. With regard to current workers, Article 15 sets out that two-way selection shall be allowed. The employees who are not retained by the purchaser or volunteer to leave are, nevertheless, entitled to their original wages and other benefits for three more months from the purchaser.

In 1989 the same state authorities promulgated the Interim Provisions Concerning Enterprise Mergers ('the Merger Provisions'). Unlike the Sales Provisions that only apply to sales of small scale SOEs, the Merger Provisions govern mergers between different sized enterprises under different ownership. Article 2 stipulates some general principles governing enterprise mergers. They include that (1) enterprise mergers shall be guided by the state economic development strategy and industrial policy; (2) mergers shall be carried out through competition on the basis of voluntariness and mutual benefit; (3) the major concerns of any mergers should be the quality and efficiency of the business which should be measured by rationalization of the structure of the industry, products and organization; (4) enterprise mergers shall not be restricted with locality, ownership, business or administrative subordinate relationship, unless the State provided otherwise; (5) while promoting economic efficiency, enterprise

[70] Social insurance and welfare schemes were not available in China until the middle of the 1980s when a pilot program of this kind was launched in Shenzhen. Despite of the fast development, in 1996 the population coverage of social insurance was still far below 40 percent in all SOEs. Moreover, with more than 20 million laid-off workers in the recent years, the bearing capacity of the newly established system is very limited. Many insolvent enterprises are simply unable to pay any premium of the insurance program. *See,* He Qinglian, *Xiandaihua de Xianjin* [The Traps of Modernization - Contemporary Economic and Social Problems in China] (Today's China Publishing House, Beijing, 1998), pp. 223-228.

mergers shall also prevent monopoly and facilitate competition; and (6) in addition to efficiency, commercial mergers may also have to take convenience of people's life into consideration.

According to Article 3, the main targets of M&As should be those that seek to be taken over; are insolvent or close to bankruptcy; have suffered loss for a long time; and are not able to change or improve their unmarketable products, nor have any hope in other alternative development.[71] Article 4 of the Provisions articulates four forms of mergers. Debt assumption: assumption of the entire debts of the target enterprise; asset purchase: purchase assets of the target enterprise; share exchange: exchange of the target enterprise's assets for acquiring party's shares; and holding control: acquisition of shares of the target enterprise to the amount to warrant the acquiring party's control. Article 9 reiterated that in principle, the acquiring party shall accept the employees of the target enterprise and this factor shall be taken into account to determine the transaction price.

In practice, many foreign investors have established their joint ventures or become sole owners of their firms through M&A under these legal schemes. Since 1998, a series of promotions were conducted in both the mainland and Hong Kong to sell, or seek investment partners for SOEs with various preferential treatments attached by the local governments concerned.[72] In many cases, the practice has apparently left the rules behind. For example, in 1992 China Strategic of Hong Kong purchased 37 SOEs in Quanzhou City of Fujian Province that represented over 90 percent of the production, sales, and employment of the city's state sector in a 'basket deal' with the local government. According to the contract, a joint venture between the

[71] Article 3 of the Merger Provisions

[72] For example, in first half of 1998, at least five provinces held promotion fairs with several thousand projects in Shenzhen or Hong Kong with the intention to attract foreign investors, Liaoning Province alone presented over 1500 SOEs for sale or mergers. *Ta Kung Bao* (Hong Kong), 15 May 1998, A8.

Hong Kong Company and a state asset investment company on behalf of the 37 SOEs was established for a term of 100 years with the Hong Kong investor's 60 percent equity holding. From the deal, the China Strategic made a considerable profit when it sold most of its holding interests to a Malaysian company within two years of its purchase; whereas the local government received badly needed cash of RMB240
million for future development and settlement of laid-off workers.[73]

In recent years, in addition to ailing SOEs, foreign firms have started to buy into profitable SOEs. For example, in May 1999 Unilever bought Jinghua Tea Company its brand garnered 70 percent of Beijing’s tea market one time. With an undisclosed price, it was noted as an exceptional case since China had yet to embrace
foreign M&As in a wholesale manner.[74] Also, a new strategy of internal acquisition has been developed. For example, Henkel of Germany has successfully put its two joint ventures in Shanghai and Tianjin under its firm control by increasing its capital contribution by taking advantage of the Chinese partners' financial difficulties. After the restructuring, Henkel's holdings in the two enterprises have reached 85 and 55 percent respectively.[75]

Despite the continued efforts of the government to improve the joint venture legal regime,[76]foreign investors have apparently become more and more unsatisfied with their joint venture operations as their projects are developing into large scale.

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[73] For the detailed analysis of the basket deal, see Tang Zongkun and others, *Guoyou Qiye Chanquan Jiaoyi Xingwei Fenxi* [Behavior Analysis of State Enterprise in Property Right Trading: Case Studies] (Economic Science Publishing House, Beijing, 1997), pp. 144-155.

[74] *See* Qian Qingpi, 'Buying into SOEs' (July 1999) China International Business, pp. 10-11.

[75] Shi Jiansan, *Kuaguo Binggou Litn* [On Cross-Border Acquisitions] (Lixin Accounting Publishing House, Shanghai, 1999), pp. 236-237.

[7622]For example, the Sino-Foreign Joint Venture Law was amended in 1990 to allow foreigners to be Chairmen of the boards of joint ventures, compare Article 6 of the Law of 1979 and the same Article of 1990. In 1995 the right of contractual joint ventures to business autonomy free from intervention of any individual or organizations was recognized by the Detailed Rules for Implementing the Sino-Foreign Contractual Joint Venture Law of PRC. Particularly, Article 3.

According to a recent study, 50 percent of joint ventures have gotten involved in bruising conflicts over how to run the business or how to share profits. A well known joint venture car company is rendered 'almost dead' after the Chinese side under the government's auto industry policy refused to allow the foreign investor to unilaterally increase its investment for the business expansion in order to meet growing demand and reduce costs.[77] As a result, a trend of restructuring investment vehicles by foreign investors has been developed in two directions: first, since 1997 when the number of newly established foreign wholly owned enterprises surpassed joint ventures, the preference for independence has been continued in recent three years;[78] and second, more investors are using company and securities market to carry their investment plans.

4.2.2 M&A in Form of Companies

Although all equity joint ventures and most contractual joint ventures are characterized as limited liability companies,[79] the first Company Law in the PRC history was not promulgated until late 1993. The Law sets out provisions governing Limited Liability Company and Joint Stock Company as two recognized corporate forms. The law, however, fails to specify to what extent a foreigner may use the modern business form in China. With regard to mergers and acquisitions, Chapter 7 entitled Company Merger and Division includes only 7 short articles.

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[77] F. Wang, 'The Thrill **Is** Gone: Chinese Passion for Partnership Fades' {November 1999) China International Business, pp. 14-15.

[78] D. Murphy, 'Til Death Do Us Part?' (November 1999) China International Business, pp. 10-11. Against the trend of foreign investors' re-positioning through M&As in China, the MOFTEC promulgated Merger and Division of Foreign Investment Enterprises Provisions on 23 September 1999. For a comment, see X. Ping and M. Schaub, 'In Practice: Reality of Merging FIEs' (February 2000) China Law & Practice, pp. 22-25.

[79] *See,* Article 4 of the Sino-Foreign Equity Joint Venture Law and Article 2 of the Sino-Foreign Contractual Joint Venture Law.

Under Article 183, any merger and division concerning a joint stock company must be approved by the ministry or the provincial government concerned. Company mergers and division may be carried out through absorption where the target company dissolves after the takeover or new establishment where a new company will be formed with the dissolution of all the parties involved. The rest of articles in the Chapter deal with assets and debts assumption, notice and disclosure, adjustment of registered capital and change of business registration. However, the Company Law does not have any extra-territorial clause. In addition to these articles, Article 12 also need to be considered, which stipulates that the accumulated investment made by a company, except state investment companies, to another shall not be more than 50 percent of its net assets. In practice, this rule may considerably limit the purchase power of the acquirer.

The issues concerning with use of company form by foreign investors were not clarified until 1995 when the Ministry of Foreign Trade and Economic Co-operation (the 'MOFTEC) as the state authority in administration of foreign investment issued two important regulations. The first one is entitled Provisional Regulations on Certain Issues Concerning Establishment of Foreign Investment Company Limited by Shares. The legal conditions to establish such a company include minimum 25 percent of foreign registered capital;[80] compliance with the state foreign investment and industrial policy;[81] at least one foreign promoter;[82] minimum registered capital of RMB30 million;[83] and

[80]Ibid. Article 2 Merger Provisions
[81] Ibid Article 4 Merger Provisions
[82] Ibid Article 6 Merger Provisions
[83] Ibid Article 7.Merger Provisions

approval by the relevant state authority.[84] A foreign investment company limited by shares may be set up through new establishment, conversion of existing joint ventures or foreign wholly owned enterprises, or acquisition of SOEs or other firms,[85] The Regulations also include the rules to enable such a company to be established by public issuing.

The second MOFTEC enactment is Interim Provisions Concerning Establishment of Foreign Investment-Type Company, which introduced holding or 'umbrella' company into China. The Provisions set out a higher standards for the foreign investor' financial strength by requiring it to have either total assets no less than US$400 million and over US$10 million paid-in capital in China with more than three approved projects; or to have more than US$30 million paid-in capital in more than 10 investment enterprises in China.[86] Moreover, the minimum registered capital of such a company must be US$30 million[87] and its final approval has to be made by the MOFTEC.[88] Among its functions to provide its subsidiaries with various services and financial support, a foreign investment holding company may also directly invest or jointly invest with other foreign investors through M&As into domestic enterprises in China to turn them into foreign investment joint ventures or subsidiaries by injecting 25 percent foreign capital.[89]

[84] Ibid Article 9 of Mergers Provisions
[85] Ibid. Articles 17 through 20 of Mergers Provisions
[86] Ibid. Article 2(1) of Mergers Provisions
[87] Ibid Article 2 (3) of Mergers Provisions
[88] Ibid. Article 3 of Mergers Provisions
[89] Ibid. Article 6 of Mergers Provisions

4.2.3 M&A on the Chinese Securities Market

M&As will inevitably trigger the inquiries on the possible strategies on the securities market. Indeed, the Chinese securities market has come a long way within just nine years since it reopened at the end of 1990.[90] By the end of 1999, 976 companies were listed in the mainland and Hong Kong with a market value of RMB2.65 trillion.[91] At the same period, Chinese companies have also successfully been listed in New York, London, Singapore and Sydney. The regulatory framework of the Chinese securities market is formed by the Securities Law of 1998 and the Interim Regulations on Stock Issuing and Trading 1993 (the 'IRSIT).[92]

However, some unique Chinese characteristics should be noted before an assessment of the feasibility for foreign investors to use the market is made. First, the Chinese securities market has been a one-way street only for Chinese companies to raise capitals. At one time, a debate arose as to whether to permit Mercedes-Benz to list on Shanghai Exchange, but soon fell apart.[93] Moreover, the market has been tightly controlled by the government. For example, it has been a practice of the government to adopt an annual quota of public issuing based on the national economic conditions and development needs; all companies proposed

[90]The securities market in mainland China was dosed down after the Communist Party took over the power in 1949. It was re-established on 19 December 1990 when the Shanghai Exchange started its operation and Shenzhen Exchange followed on 3 July 1991.

[91]See the report on Renmin Ribao [People's Daily - Overseas Edition] 4 March 2000, p. 5

[92]It is interesting to note that unlike the normal practice in legislation in other field, the adoption of the first Securities Law of the PRC at the end of 1998 did not include any provision to supercede the IRSIT as the provisional regulation. As a result, the IRSIT may still be applicable to the extent not contradictory with the provision of the Law

[93] N. Tiehang, 'Stock Market Integration in Hong Kong and China' [1997] 6 Journal of Contemporary China, p. 493. A call for opening the domestic securities market for foreign enterprises was also made in a research project sponsored by the Canadian Government. See Deng Hongguo and Wang Zhichao, 'Zhongguo Zhengquan Shichang Fazhan Xianzhuang ji Guojihua Qianjing' (The Current Status and Perspectives of Internalization of China's Securities Market) in: Deng Hongguo (ed), *Zhongguo Jinrnng Shichang de Fazhan yu Guojihua* [The Development and Internationalization of China's Financial Market-A Comparative Study of Cases of China and Canada] (Financial Publishing House of China, Beijing, 1996), p. 182.

for listing must be recommended by the relevant government authorities under a policy to ensure SOEs' preferential access to the capital market; and the government may also use its influence to control the market.[94] Further, the market has been irrationally divided from the very beginning. Among common stocks held by domestic parties known as A shares, further division is made to differentiate state shares, legal person shares (which are held by state owned firms) and individual shares. Thus far, state shares and legal person shares have made over two third of the total issuing,[95] and cannot be traded on the open market and transferred to other class holders without state authority's approval.[96] Article 93 of the Securities Law provides that any acquisition of listed companies involving state shares held by the state investment entities must be approved by the state authority concerned. As a result of such division, trading of A shares has only referred to the transactions among private investors, which represents merely less than 30 percent of common stocks issued.[97] This rigid separation, according to the government, is designed to prevent public ownership from being lost.[98]

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[94] In two recent cases, the government's powerful commentaries published on the official newspaper of the Central Committee of Communist Party sank the market indexes by one third within six days at .the end of 1996 and created a blowout with indexes up by over 35 percent within a month in summer 1999. For a comment on this practice, see Foo Choy Peng, 'Party Line Ignored as Shares Dive', South China Morning Post, 8 July 1999, the special section: China Business Review, p. 1. For a critical comment, see Guo Feng, *Zhengquan Jiangtuin yu Ufa* [Securities Supervision and Legislation] (Legal Publishing House, Beijing, 2000), pp. 12-13.

[95] Liu Lifeng, 'Oguo Gupiao Shichang Fazhan Ruogan Wenti' (Certain Issues Concerning the Development of Securities Market of China) [2000] 2 *Zhongguo Touzi* [China Investment], p. 27; *see also* 'State Owns Too Big in Listed Companies - An Interview with Liu Shaobo of Guangdong Securities Association' (10 November 1997) China Economic News, pp 6-7.

[96] Article 36 of the IRSIT. It further states that transfer of state shares shall not harm the rights and the interests of the State.

[97] *See* Liu, *supra* note 42.

[98] As Mr. Liu Hongru, then Chairman of the China Securities Regulatory Commission stated that safeguarding the dominant position of the public ownership and preventing state assets from being harmed were principles that the Chinese securities market had to follow. The Legal Department of the CSRC, *Zhengquan Shifhang Zhuanjia Tan* [Experts on Securities Market] (Chine University of Political Science & Law Press, Beijing, 1994), p. 24.

Under the current regulation, B shares are domestically listed and traded foreign capital common stocks which shall only be held by foreign investors, including those from Hong Kong, Macau and Taiwan.[99] B share market in China has also been separated from A share market in China because of not only the political policy to safeguard the public ownership, but also the technical problem of inconvertibility of *Renminbi.*[100] In the Chine-US negotiation on China's entry into WTO, Premier Zhu Rongji made it clear that although B share market will continue to be available to foreign investors, A share market would not be open in the near future.[101] Soon after Isuzu and Itochu purchased 25 percent of A shares of Beijing Lightbus Co. from some domestic legal persons in 1995 by taking advantage of certain regulatory loopholes,[102] the China Securities Regulatory Commission (the 'CSRC') as the responsible government authority issued a circular to suspend such foreign acquisition of state or legal person shares on the ground that without sufficient legal protection, state assets might be washed away through such transactions.[103] Later, Guanghua Chemical Fibre, a Shanghai listed company was penalized with trading suspension for a transfer of 25.4 percent shares from the state holding to Nimrod of US. The ban was again vigorously reiterated by the CSRC in

[99]Articles 3 and 4 of the Provisions Concerning Foreign Capital Shares Listed within the Mainland China promulgated by the State Council on 25 December 1995.

[100] As some commentators pointed out, China has been facing a dilemma: introducing more foreign capital into China through the securities market and worries about the foreign capital control. Thus, the separation of the market and foreign exchange control may not be abolished soon. *See,* Ou Tang, 'Certain Issues Concerning Foreign Mergers and Acquisition of Listed Companies' in: China, *Xianggang Jinji Daobao* [Economic Journal], 31 August 1998, pp. 32-33. This view has been endorsed by Premier Zhu Rongji. In his recent news conference, he stated that there would be no timetable for free convertibility of *Renminbi.* See *Renmin Ribao* [People's Daily], 16 March 2000, p. 2.

[101] Statement made by Premier Zhu in his interview with the Wall Street Journal, Wall Street Journal, 5 April 1999, which was translated into Chinese, *Ming Pao* (Hong Kong), 7 April 1999, A4

[102]For a discussion of the transaction, see C. R. Capener, *A Guidebook to Mergers and Acquisition in China,* (Asia Information Associates Ltd., Hong Kong, 1996), p. 71.

[103]The CSRCs report to the State Council Concerning Suspension of Transfer of Shares of Listed Companies Held by the State and Legal Persons to Foreign Business Concerns, which was approved by the State Council on 23 September 1995.

its decision.[104] As such, the *de facto* inequity concerning unequal access to information, unequal liquidity, unequal price and unequal formalities to transfer has been long complained.[105]

Despite its inherent problems, at one time B share market seemed to provide foreign investors another channel to acquire shares of listed companies. In 1995, Ford Auto purchased 80 percent of B shares issued by Jiangling Auto of Jiangxi Province, which made it a shareholder with 20 percent common stocks of the listed company. However, in a circular issued in early 1998, the CSRC decided that as a principle a company may only issue one type stocks, namely either A shares as domestic capital stocks or foreign capital stocks such as B shares in the

mainland or H shares in Hong Kong securities market.[106]Despite the intention to promote more companies to be listed within the state quota, two negative implications on foreign M&As are that (1) with less diversified structure, it may be more difficult to challenge the state holding control; and (2) some companies may give up their overseas listing so as to avoid the higher listing standards and costs.[107]As a result, it may be less foreign capital shares available for foreign acquirers.

The M&A rules on the securities market have been slowly developed. When the first hostile takeover took place on the secondary market in 1993, the parties had to invite some experts from Hong Kong for advice. Also, by taking into

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[104] The CSRC's news release dated 25 January 1996. *See also,* Clement Au-Yeung, 'Row Erupts over State Share Dealing' (October 1996) China Law & Practice, pp. 27-28.

[105] Chengxi Yao, *Stock Market and Futures Market in the People's Republic of China,* (Oxford University

Press, Hong Kong, 1998), p. 20; and K. Matthew Wong, 'Securities Regulations in China and Their Corporate Finance Implications on Stale Enterprise Reform' [1996] 4 Fordham Law Review, p. 1225.

[106] Sec. 1 of the CSRC Supplementary Notice on Certain Issues Concerning Stock Issuing dated 17 March 1998.

[107] After the promulgation, some domestic companies that had obtained state approval for Hong Kong listing turned their backs to the option and decided only to be listed in the mainland. See the interview with Former CSRC Chairman Liu Hongru, *Da Kong Pao* (Hong Kong), 29 April 1998, C3.

account of the pioneer practice, the CSRC ruled the acquisition was valid, although the acquiring party was penalized for violations of disclosure and report duties.[108] Currently, most M&A rules applicable to securities market are provided in the Securities Law.

Under the Law, acquisition may be carried out through either tender offer or by agreement,[109] which is designed to liquidize state shares between different state entities.[110] In case of acquisition through tender offer, the framework apparently follows the model of the United States.[111] An investor shall file a written report with the CSRC and the Exchange and publish it within three days when his holding amounts to 5 percent of a listed company. Afterwards, such report and publication need to be made by the acquiring party with his every holding fluctuation of *5* percent. During the reporting period and within two days of the publication, the trading for acquisition must be paused.[112] Once the holding reaches 30 percent of the common stock of the target company as the threshold, with certain exemptions, a tender offer shall be made to all shareholders if the acquiring party intends to carry on the acquisition.[113]

Before any tender offer is made, however, the acquirer must submit its acquisition report to the CSRC and the Exchange with detailed information of the purpose, quantity, terms and funds involved of the takeover.[114] The tender offer period shall not be less than 30 days or longer than 60 days.[115] At the end of the

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108 For a comment, see Liu Wentong, *Gongci Jianbing* [Company Mergers and Acquisitions] (Beijing University Press, Beijing, 1997), p. 228.
109 Article 78 of the Securities Law
110 Drafting Group of the Securities Law: *Zhongguo Zhengquanfa Shiyi* [The Securities Law of the PRC- An Annotation] (Reform Publishing House, Beijing, 1999), pp. 167-168.
111 Compared with the provisions in Rule 13d-l of the Securities Exchange Act 1934 and Williams Act of 1970 as the later Amendment.
112 Article 79 of the Securities Law
113 Ibid. Article 81 of the securities law
114 Ibid. Article82 of the securities law
115 Ibid. Article83 of the securities law

period, trading of the target company's stocks will be terminated if more than 70 percent of the total shares have been acquired by the acquirer; a 90 percent holding of the acquirer at the end of the period further entitles the rest of shareholders to a mandatory purchase by the acquirer on the same term of the tender offer.[116] Article 84 provides that during the tender offer period, the acquirer shall not withdraw his offer and any change of terms must be approved by the CSRC.

4.2.4 Market Access

Besides all the difficulties with the investment vehicles, there is at least one more major hurdle for cross-border M&As in China. In 1995, the MOFTEC promulgated the Interim Provisions on Guiding the Directions of Foreign Investment with a Guiding Catalogue of Foreign Investment Industries. The Provisions classify foreign investment projects into four categories: encouraged, allowed, restricted, and prohibited, which indicate the likelihood of the government approval.[117] The encouraged investment fields include infrastructure, agriculture, hi-tech, new materials or energy or remote area development.[118] On the other hand, some politically or economically sensitive businesses are defined as either restricted or prohibited. Telecommunication market, for example, has virtually not allowed foreign entry yet. Moreover, as a means of further control, quite a few business areas demand certain foreign investment forms, such as 'wholly foreign owned operation not permitted' or 'state holding control required'. Although the Guiding Catalogue was revised at the end of 1997 to reflect the further opening to foreign investment and certain policy changes, practitioners still considered the amendment failed to meet their expectation. In certain sectors such as medical facilities and foreign

[116]Ibid. Article 87.
[117] Article 4 of the provisions.
[118] Ibid. Article5.

trade, the state control even stepped up by not only prohibiting wholly foreign owned enterprises, but also requiring domestic party's controlling or majority holding in any joint ventures in such business fields.[119]

On 14 September 1998 the State Commission of Economy and Trade promulgated Interim Provisions Concerning Asset Reorganization of State Owned Enterprises by Using Foreign Investment as the latest regulation in foreign M&As of SOEs. In addition to rules on examination procedures, the Provisions further set out four principles: (1) the MOFTEC's Guiding Provisions on Foreign Investment and the Guiding Catelogue must be strictly followed; (2) proper arrangements must be made for the laid-off workers; (3) state assets must be safeguarded; and (4) bank debts cannot be evaded.[120] Further, the Provisions state that an investment project of less than US$30 million shall be approved by the provincial government or the ministry concerned; the final approval of a project between USS30-100 million shall fall into the jurisdiction of the State Commission of Economy and Trade; and any investment project of over US$100 million must be approved by the State Council.[121]

The discussion above clearly tells that the rules governing M&As are still developing and have not reached a sophisticated level. Many markets are not open to foreign investors yet. The current provisions are rather general principles than detailed functioning rules and have never been seriously tested in the courtroom. Many necessary institutions, such as minority shareholder protection, fiduciary duty of directors, antitrust and due diligence, defensive tactics are still missing. Although the State Council drafted a uniform Enterprise Merger Regulation in 1998 with

[119] For a comment, see Guanxi Zheng and H.L. Fu, 'New Investment Catalogue Disappoints' (January/ February 1998) China Law & Practice, pp. 51-53.
[120] Article 3 of the Interim Provisions.
[121] Ibid. Article5.

some rules on minority protection and anti-trust, it has not been formally

adopted.[122]

4.6 Mode of Acquisition

An acquisition may take the form of a stock acquisition, an asset acquisition, or the acquisition of control. The acquisition often includes the acquisition of an enterprise. The purchaser must determine if the purchase is an acquisition of stocks or assets. Generally speaking, the determination is made in relation to the liability of a target firm. In an acquisition of assets, the acquirer decides to buy all the assets of the target business without any liabilities; on the other hand, the acquirer gets the ownership of the target company and is entitled to both its assets and its liabilities in the course of the share acquisition. In many cases, it is the acquirer's due-diligence review of the target company that enables the acquirer to decide whether to acquire assets or shares. There are also instances of acquiring the business of a company as a going concern, whereby the assets, liabilities, and employees are acquired for a lump-sum consideration.

4.7 Transactional Issues

Finalizing an acquisition requires that various transactional issues be discussed, negotiated, finally agreed upon and properly reflected in the definitive purchase agreement. The representations and warranties of the company to be acquired and of the seller--especially the representation that full disclosure has been made to the acquirer--are an important part of that agreement from the acquirer's perspective, whether or not the transaction involves a cross-border Indian acquisition. The seller will seek to qualify its representations and warranties to reflect what has come to light in the due diligence exercise.

India being a country with a vast number of laws, it is necessary for a foreign acquirer to have the comfort of knowing to what extent the target company has been in compliance with those laws; moreover, the acquirer will want full disclosure of those matters as to which there has not been compliance. As for the issue of the post-closing survival of representations and warranties, it is

typical for the parties to agree to a survival period of between three and four years. As for the issue of indemnity, the concepts of de minimis liability for which there is no recourse and of an overall cap on potential liability, as well as requiring a minimum threshold or basket amount before the seller can be held liable, are concepts that will likely be put forward by the seller to reduce its exposure to a certain extent. In the negotiation of such liability limits, it is essential for the acquirer (who, of course, will seek a blanket indemnity without ***57** any limits or caps) to keep in mind the local laws of the relevant country and the type and value of the claims that may arise.

Conditions precedent to closing are essential in addressing and ensuring that all approvals and consents have been obtained to allow the transaction to be consummated. Moreover, conditions precedent to closing that involve curing any problems that were discovered during the due-diligence review help ensure that the acquirer will not also acquire those problems at closing.

4.8 Conclusion

Based on the discussion above, it is obvious that the law and practice of M&As in China are still developing and have a considerable gap with commonly accepted standards, due to not only lack of experience, but more ideological difficulties. Thus far, a uniform national M&A law has not been adopted, nor many other indispensable laws. However, the aggressive foreign investment through M&As has pushed the government to speed up the legislation and solve the policy dilemma between utilization of foreign capital and protection of national industries.

Recently, the Chinese Government further committed itself to a market economy and integration into the trend of globalization by concluding agreement with its WTO entry with the US and the European Union. Under both agreements, foreign investors would gain more market access, enjoy more national treatment, and increase their equity holding in certain sensitive service sectors up to 49 or even 50 percent.[138] This significant development will further enable foreign companies to access to the Chinese market with M&A means and many of them are already considering ways to adapt their current and future operation in China to WTO-induced changes.[139] Also, the government recently announced that intermediaries would no longer be linked with government departments by the end of 2000 in order to ensure their work independent and unbiased. As a result, the former state controlled China Association of Certified Assets Appraisal Agents, China Association of Certified Taxation Agents and China Association of Certified Accountants has merged for professional supervision and discipline. The merge affects 300,000 practitioners and tens of thousands of firms in China.[140]

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[138] For the key points of the Sino-US WTO Agreement, see The China Business Review, January-February 2000, pp. 21-27; for the key points of the Sino-EU **WTO** Agreement, see Simmons & Simmons, *China Bulletin: Foreign Direct InvestmentChina and the European Union,* no. 13, June 2000.

[139] *See* the Special Report: 'PNTR -The Next Step for the United States' (January-February 2000) The China Business Review, pp, 28-30.

[140] Xu Dashan, 'State to Sever Its Intermediary Firms', China Daily, 24 May 2000, p. 1.

As such, it can be expected that the M&A legal regime in China will experience some fundamental reform in coming years and eventually be transformed into a market-centered modern system governed by rule of law. At the same time, the overall business environment will also be improved with the market development.

It should be noted that all corporate matters and rights extended to the parties to a transaction need to be adequately reflected in the articles of association *(i.e.,* the bylaws of an Indian company), so as to be enforceable against the Indian company. However, since an Indian public company cannot restrict the transfer of its shares, shareholders, in addition to a shareholders' agreement, also enter into a nondisposal agreement, in which they agree to transfer their shares only in the manner provided therein, important element of merger and acquisitions-involving a foreign company and an Indian company is the status of the Indian company, that is, whether it is a private limited company or a public limited company. A private limited company is more able to provide for restrictions, and the investment involving such a company can be structured in a more suitable manner since a private limited company is not restricted to having only two classes of shares *(i.e.,* equity and preference), as is the case for a public company, *There* have been cases in which an acquirer has identified a target company that is a public company, but, for the purpose of the acquisition has structured the transaction so as to convert the target company into a private limited company before proceeding with the acquisition.

CHAPTER5

SETTLEMET OF DISPUTES I CROSSBORDER MERGERS & ACQUISITIOS

5.1 Introduction

Entrepreneurship is widely recognized as creating value, and is strengthened as a business grows. Creating jobs, satisfying the needs of its customers and, in the process making money for the shareholders, are events jointly referred to as *shareholder value,* a catch phrase performance charts.[141]

Cross-border mergers have been proven as a very effective strategy for creating value. As such, they have been used by a variety of companies to achieve growth, and to access markets and technology world-wide, in an increasingly competitive global arena.

The term *merger* will be used in this article to refer to any change of ownership situation where a company acquires operating control and/or at least the majority ownership of another; or when two companies combine to form a totally new entity. In other words, the phrase encompasses mergers, acquisitions and take-overs.[142] The term will be used throughout this lecture partly because of its simplicity, and also because it strikes the author as the least-threatening meaning of these three terms.

In the last quarter of 1996, business optimism rose in the financial services sector at the fastest rate since the end of 1989. This optimism was a direct consequence of corporate restructuring, the economic star of 1996, brought into vogue mainly by defense, aeronautical, and chemical and pharmaceutical companies.

[141] Bharat, "Corporate Mergers, Amalgamations and Takeovers", 4th ed. 2002
[142] J.Fred Weston, "Merger, Restructuring, And Corporate Control", 1996

World-wide cross-border mergers and acquisitions accelerated in 1997, rising by 21 percent to a new record of US$332.55 billion. However, investment by international companies has fallen throughout much of Asia in the wake of the region's financial crisis.

In 1998, total international mergers and acquisitions rose by some 60 percent over 1997 in announced transactions.[143]

Further, traditional private equity investing is also fuelling the M&A market. To investment banks, it is now worth in excess of US$2.5 billion in fees. Resultantly, the value of mergers and acquisitions transactions in 1999 has been estimated to be over US$2.2 trillion. This figure makes 1999 another record year in mergers and acquisitions activity.

This boom offers rich rewards to almost everyone involved, but few are reaping as much as the banks that lend to borrowers with large appetites.

In early 1997, two Finnish engineering groups merged a transaction that created the world's leading producer of cargo-handling machines and equipment[144]. Likewise, two Netherlands' regional electricity producers merged. However, the practice made its breakthrough in the UK with the proposed merger between British Telecom and MCI, the US telecoms company.

Mergers and acquisitions, on an unprecedented scale, have reshaped the telecommunications and technology sectors over the past three years.[145]

In 1996, the liberalization of world telecoms markets was initiated. The enactment of the US Telecommunications Act pulled the checked-flag down. In 1997, the World Trade Organization entered into an agreement in this field. Finally,

[143] Maher Dabbah, “Merger control worldwide, 1st ed. 2006.
[144] Scott Slorach, “Corporate Finance, Mergers & Acquisitions”, 2002.
[145] V.K.Puri, “Corporate Mergers & Acquisitions”, 2nd ed. 2008

European Union decisions took effect in January 1998. These landmarks unleashed an explosion of activity, which has resulted in unprecedented deals between some of the world's largest operators.

In the US, the most recent move by Cisco Systems - the telecoms group - to pay US$6.9 billion in stock for Cerent Corporation, a company that was founded in 1997, stands testament to the power of the telecommunications purse. In a deal that is yet to be completed, Bell Atlantic - the regional Bell operating company - is paying US$71.1 billion to acquire GTE, another regional and long distance operator. SBC Communications is paying US$62.6 billion to acquire its fellow regional operating company Ameritech.

The ideas that spring from the West Coast are reverberating throughout the world, affecting much of the traditional old European order and the Asian market.

In European fixed-wire services, Olivetti - the Italian, one-time typewriter company, that turned itself into an information technology group - bought Telecom Italia, in deal worth US$33 billion in stock and cash; warding off an equally bold attempt by Deutsche Telekom to annex the privatised Italian national operator.

In the first six months of 1999, because of its existing customer relationships and local branding, GTS - the US-based European operator-acquired Esprit, Omnicom and Netsource.

In January 1999, the merger of UK's Vodafone and AirTouch - its US wireless telecomm counterpart - merged for US$65.9 billion. Besides being recorded as the largest deal in 1999, it has created a group with more than 22 million subscribers.[146]

The Asian market saw dramatic developments, when Cable and Wireless from the UK mounted and won a bidding contest for the Japanese long distance operator

[146] M.Govindarajan, "Takeovers, Merger & Amalgamations-some issues"' Executive Chartered Secretary, Vol.4, April, 2007

IDC against NTT. This bid has been seen as a measure of the openness by the Japanese market. British Telecommunications and AT&T, a US company, took a 30 percent stake in another long distance operator, Japan Telecom.

It is remarkable how important mergers and acquisitions have become for the young Internet industry.

Internet companies currently find themselves with stratospheric share prices and an overwhelming array of opportunities. It is generally thought that equity should be used to buy up as large a position on the web as possible.[147]

The most acquisitive businesses have been the large portals, companies such as Yahoo!, AOL and Lycos. These businesses combine a vast array of different services from search and directory, to chat, email, news and financial information. In some ways, the group works as a pack. If one company adds a new service to its array of offerings, its competitors are not far behind. Often this is achieved by buying up small specialist web sites.

The remarkable US$5 billion merger of Heathen and WebMB took place in 1999. Likewise, the merger between Excite - which provides contents - and AtHome -which provides Internet access over cable TV connectors - is intended to create a new AOL for people linking to the Internet through cable TV. The merger between CDNow and N2K - two music second line retailers - was imperative to compete against the ravenous giant, Amazom.com. Similarly, Egghead.com and Onsale.com are two online sellers of electronic goods that have agreed to merge in the last year.[148]

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[147] K. Gleason, L. Rosenthal and R. Wiggins, "Reverse takeovers: Backing into being public" (2005) 12 Journal of Corporate Finance.

[148] Michael Jensen and Richard Ruback, “The Market for Corporate Control: The Scientific Evidence,” Journal of Financial Economics 11 (1–4) (April 2008)

The mergers and acquisitions wave sweeping over Europe is still a phenomenon taking place within, rather than across, national borders.

Few events better illustrate the advance of modern mergers and acquisitions practice as the ones in Central Europe, especially the announced US$2 billion merger plan by Bank Handlony and BRE BANK, two of Poland's largest banks. The planned merger between Mol - the Hungarian oil group - and Ina - its Croatian counterpart -is also relevant, since the two region's biggest companies find themselves increasingly constrained by home country boundaries and look abroad to expand.

With notable exceptions, such as the creation of Aventis through the marriage between Hoechst and Rhone-Poulenc, the most significant intra-European mergers and acquisitions deals announced in the last year have been a one-nation affair. Wai-Marts' success in supplanting Asda, by taking over Kingfisher, was a wake-up call for the link between Carrefour and Promodes, which will create Europe's biggest retailer. The French merger sent a frisson through every other mass-market retailer, persuading
them that the change was coming.[149]

5.2 The 4 P'S

5.2.1 The Planning Stage

The other side of this optimism, are the challenges with post-merger management,
which intensify during the implementation of these transactions.

Challenges in post-merger management exist because before entering the transaction itself - the so-called pre-merger planning stage - companies were in

[149] Patrick A. Gaughan, Mergers, Acquisitions, and Corporate Restructurings, 2nd ed. (New York: John Wiley & Sons, 2008)

related businesses, independent, stand alone subsidiaries, and leaders in their own markets. After completing the transaction, the optimistic visions that guided each of the merged organizations are questioned.

Uncertainty and instability within the merged or acquired companies often follow, Essential managers leave, disagreements persist on organizational and operational issues, some customers do not renew their contracts, and financial performance is below the expectations foreseen in the preliminary negotiations. By capitalizing on these uncertainties, competitors can gain market advantage.

In short, any merger introduces benefits and confusion at the same time.

Nevertheless, many inexperienced acquirers still ignore their first important task: the restoration of the stability of Purpose, Power, People and Projects, commonly referred to as *the 4 Ps.*

5.2.2 Role of New Technologies

Synergies are vital to the success of these kinds of mergers. A merger may create a significant world leader in a special market, with complementary technologies, which will develop the unique strategic position of the merged company in the global market place. The existence of this situation means the existence of benefits in areas such as, procurement, research and development of new products, and cross selling.[150]

5.2.3 Importance of DueDiligence

Pre-deal planning and post-deal implementation goes hand-in-hand with synergy evaluation.

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[150] Ranjan Mukherjee, "An overview of pre and post M & A deals", Executive Chartered Secretary, Vol.4, April, 2007.

During the pre-deal planning, it is critical to work out its mechanics. It is often felt that if negotiations fail, senior management and resources spent on pre-deal planning have been wasted. Usually, in these kind of transactions, company management has a honeymoon period of 100 days or so after the deals completion to begin delivering benefits to the shareholders. Otherwise, if stockholders do not see results quickly their support will be lost and the project derailed.

At this stage, post-deal implementation and due-diligence become the most important activities of the transaction. Due-diligence includes market reviews, risks assessments and the definition of management competencies.

5.2.4 The Human Resource

In addition, parties involved in a merger devote additional efforts to other crucial issues such as human resources, the management team, the overcoming of the clash

of cultures and the implementation effluent communication channels.[151]

In either case, cultural factors must be incorporated into all elements of the merger process, from pre-deal planning to post-deal implementation. In fact, a merger is more likely to succeed if the merged companies use reward systems to stimulate cultural integration and/or co-operation.

Human resource issues are the most difficult to resolve. Staff must be motivated and incentives must be put into place. This requires careful planning and researching. Hence, the selection of management must be prioritised in the pre-deal period, so that the transaction is more likely to succeed.

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[151] S.Dhanpal, "Procedural Compliance Relating to De-merger/Reconstruction of companies in India", Executive Chartered Secretary, Vol.4, April, 2007

5.2.5 Communication

Communications with customers and /or the public are also important. But can often be safely phased in over the long term, once a value realization program is under way.

5.4.2 eutral Expert

Provisions of this nature should tailor the process to the particular problem, mainly disputes between the parties relating to a one or several Fiscal Year Accounts in accordance with General Accounting Principles. Its wording must be refined, simple, of easy access, and conducive to resolving disputes early at the lowest organizational level with the least bureaucracy. In *Whirlpool Corporation v. Philips Electronics .V.,* [155] both parties formed a joint venture following the terms of a Reorganization and Purchase Agreement, whereby Whirlpool acquired a controlling interest in certain Philips operations. The Reorganization and Purchase Agreement contained two dispute resolution clauses, one of which provided the following resolution procedure for disputes concerning financial statements:

> '(...) In the event of any dispute arising between WHIRLPOOL and PHILIPS with regard to the financial statements (...) the Parties shall refer the disputed matters for resolution to Arthur Andersen & Co. or such other major accounting firm as the Parties may agree, and shall instruct such independent public accoun-tants to follow PHILIPS' Accounting Policies in resolving any disputed matters. The determinations by such independent public accountants shall be... final and binding on the Parties (...)'

The parties may choose to regard the expert's factual determinations as binding or advisory, and allow the experts to make a binding disposition of the matter. Parties who decide to refer disputed issues to an expert should also consider, in advance, the extent to which the expert's determination will be binding, not only upon the parties, but also upon an arbitration tribunal. But, as the American Courts have generally

[155] US Dist. Ct., S.D.N.Y., 93 Civ. 5026 (1 April 1994 RWS).

held, contracts with provisions providing for accounting arbitration of financial state-ments should be broadly construed to cover all disputes, except those which are expressly excluded.

5.5 Practical Considerations Affecting Arbitration in CrossBorder Mergers

5.5.2 Rules of selecting Arbitration

With regard to the first question - selection of the type of arbitration – the relationship between the parties is the key issue, combined with the extent to which the devised rules, if an *adhoc* arbitration, or the chosen set of rules, if an institutional one, suit the dispute resolution needs and whether any additions to the rules are desirable and possible.

Agreement on a set of arbitration rules - either pre-existing or tailored - is important because the local law usually does not contain detailed procedures for conducting the arbitration. Needless to say, the purpose of setting or designating a certain set of rules of procedure is to inform the parties involved in the transaction on how to trigger the arbitration, terms, witnesses and expertise, cross-examination and many other important issues, including the calculation of the arbitrators' fees. Whether or not to modify or negotiate the set of arbitration rules chosen will depend on the type of arbitration finally selected by the parties.

Moreover, if the parties to a cross-border merger transaction have a good relationship and are confident that, should a dispute arise, they would be capable of maintaining an ongoing and constructive communication, then it may be advisable to avail themselves of the advantages which a carefully designed *adhoc* procedure can offer. *Adhoc* arbitration may result from the parties entirely devising the procedures which they intend to follow at the negotiating table or from specifying that one or another set of rules shall serve as the gap-fillers in the event that contingencies for which no procedures have been specified arise.[158]

On the other hand, since ad-hoc arbitration is not institutionally supervised, its main disadvantage is the lack of established procedures and a record of

[158] Michael Bradley, Anand Desai, and E. Han Kim, “The Rationale Behind Interfirm Tender Offers,” Journal of Financial Economics 11 (1–4), (April 2008)

accomplishment upon which to base a confident expectation.[159] Likewise, the selection of sound arbitrators, by the parties, which are capable of reaching a correct result and writing an enforceable award, is critical. In fact, it is also advisable that the parties designate an appointing authority.

5.5.3 Institutional Arbitration

Nevertheless, commentators have observed that in cross-border merger transactions institutional arbitration may be preferable to *adhoc* arbitration disputed because the parties involved are more comfortable with institutional arbitration.

In merger transactions a lot of money is at stake, due to the specialization and multiplicity of the parties, and the sophistication of their business. Thus, arbitration institutions world-wide provide important administrative services and assistance with the appointment of arbitrators. These institutions maintain updated lists of qualified lawyers and lay people in various fields and different nationalities with experience as arbitrators. Additionally, these institutions have the necessary administrative and clerical infrastructure to fix the amount of and arrange for the arbitrator's fees, determining the place of arbitration, if necessary, secure deposits from the parties that are sufficient to defray the costs of arbitration, and arrange hearings. Lastly, they provide the parties with sets of rules that have been devised on the basis of a longstanding and specialized practice.

As stated beforehand, the fact that a variety of holding companies are likely to be involved in these kind of operations, multiparty arbitration is foreseeable in transna-

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[159] Naveen Bhatnagar, “Mergers and Acquisitions- Will it be effective in Indian context”, Executive Chartered Secretary, Vol.4, April, 2007

tional merger disputes. Multiparty litigation encompasses and variety of situations, as well as an assortment of remedies that could be adopted.

5.5.4 Multiparty Arbitration

Multiparty arbitration is arbitration's equivalent of squaring the circle regarding the number of arbitrator's, multiparty arbitration agreements in merger transactions may not specifically stipulate the appointment of an arbitrator of the arbitration panel. There is a real risk that the parties may not receive equal treatment by the same tribunal.

The UNCITRAL rules and Model Law set up a mutually complementary regime to ensure that all parties to a multiparty dispute are treated with fairness and equality. Key decisions on the matter, including, *Westland Helicopters Ltd.v. the Arab Organization for Industrialisation, the United Arab Emirates, Saudi Arabia, Qatar, the Arab Republic of Egypt and the Arab British Helicopter Computer; BKMI Industrieanlagen GMBH v. Dutco Construction Co. (Pvt.) Ltd. and Government of the United kingdom v. Boeing Co.,* must be analyzed.[160]

As far as multiparty arbitration proceedings are concerned, an issue as to the consolidation of various arbitration proceedings with multiparty related, but formally independent parties, requires that the parties explicitly consent to the possibility of consolidation. In fact, only five national jurisdictions (Hong Kong, Australia, Canada, British Colombia, the Netherlands and Ecuador) have expressed legislative enactments allowing for mandatory consolidation of arbitration proceedings under certain circumstances. In any other case, and unless the parties in their arbitration agreements have conferred discretionary authority on the arbitration panel or the

[160]Patrick A. Gaughan, Mergers, Acquisitions, and Corporate Restructurings, 2nd ed. (New York: John Wiley & Sons, 2008)

court, any exercise of discretion on the part of an arbitration tribunal or court to consolidate arbitration proceedings based on considerations of efficiency will be forbidden.

5.5.5 Issues Related to Mergers Transaction

Once the type of arbitration and the corresponding *lex arbitrii* have been chosen, and certain procedural matters settled, the next issue concerns defining the arbitrable disputes related to the merger transaction and precisely limiting their scope.

Frequently, when defining arbitrable disputes, lawyers tend to list every type of foreseeable dispute except those regarding the definition of the main characters that enter into the transaction itself.

As we have pointed out beforehand, an increasing number of transnational mergers engage more than one party on each side: For example, holding companies are often used in these transactions as intermediaries. The transaction itself takes the form of packages consisting of several contracts entered into by a formal multitude of parties, and may be implemented in a set of related documents, with several arbitration clauses and different signatories, which closely refer to each other, and which support and complement each other, thereby creating a contractual network.[161] If these crucial factors are ignored at this early stage, then the parties involved must eventually resort to a separate arbitration proceedings. The likelihood of delay, high and duplicative costs, and inconsistent findings are great. Therefore, in addition to the express consent of the parties involved to consolidate, already mentioned, it is highly advisable, for the purposes of consolidation, to have the arbitration clauses

[161] R. Comment and G. Jarrell, “Corporate Focus and Stock Returns,” Journal of Financial Economics

coincide with each other - that is to say, be identically written - and cross-related to any other document or party that conforms the transaction itself.[162]

Although these documents appear to be independent from each other, the fact is that they make up a single economic unit: the merger transaction itself. Each document can only be understood in relation to the other, and both together only in relation to the sole legal transaction formalized by these documents.

The concept of an economic unit - that has been defined in arbitration case law with respect to a corporate group - implies acceptance of an arbitration clause by a party who has not expressly signed it, but who is nevertheless sufficiently proven to be bound by it. However, this is only the case when the party has effectively participated in the negotiation, conclusion or termination of the contracts that contain the arbitration clause, regardless of the fact that it was not signed by it.[163] This concept is also applicable to networks of legally-independent persons or entities which are effectively controlled, organized and managed by one or several other person or entities, all of which are subject to a single decision-making center, thereby constituting a single economic unit. For reference is the well-known arbitration award rendered under the auspices of the *Society of Maritime Arbitrators in MAP Tankers Inc. v MOBIL Tankers Ltd.,* as well as several ICC awards, like those rendered in cases 2375/1975 and 4131/1982 (The Dow Chemical Case).

[162] Ranjan Mukherjee, "An overview of pre and post M & A deals", Executive Chartered Secretary, Vol.4, April, 2007.

[163] Pesi M.Narielvala, "Merger & Acquisitions- some issues of corporate governance & public policy", Executive Chartered Secretary, Vol.4, April, 2007.

5.5.6 Drafting of Arbitration clause

At this point, we reach the second set of problems that can arise from the mismanagement in drafting an arbitration clause.[164]

Practitioners are familiar with the fact that parties are free to agree on a governing law in the arbitration clause that is different from the one governing the transaction. However, in transnational arbitration, the parties often lack this agreement. As a result, at the end of the day an unfamiliar law is frequently chosen without the assistance of a domestic lawyer familiar with the unique characteristics of the chosen law and the foreseeable problems that are likely to arise. Likewise, the place of the arbitration is chosen for reasons based on the quality of the local hotels, restaurants and flight connections. This is a common and very big mistake, with unexpected serious financial consequences for either or both of the parties to the merger transaction.[165]

5.6 Arbitrability of CrossBorder Merger Disputes

5.6.1 Jurisdiction of the Arbitration Tribunal

Arbitrability is of utmost importance. As a classic sensitive area, it raises several questions relating to the jurisdiction of the arbitration tribunal itself, and competition and antitrust law, which are complex matters.

With regard to the jurisdiction of the arbitration tribunal, an example: if Switzerland is chosen as the venue of the arbitration, the documentation of the merger transaction must show that none of the parties had its business address in Switzerland at the time of the signing of the arbitration agreement. It must also show they

[164] K. Gleason, L. Rosenthal and R. Wiggins, "Reverse takeovers: Backing into being public" (2005) 12 Journal of Corporate Finance 54.
[165] Michael Bradley, Anand Desai, and E. Han Kim, "The Rationale Behind Interfirm Tender Offers," Journal of Financial Economics 11 (1–4), (April 2008)

designated Switzerland as the seat of the arbitration by mutual agreement, without determining the *lex arbitrii* to be applied to the arbitration agreements. And, eventually, that after signing the arbitration agreements, the parties at no time expressed any written reservation as to the applicability of Chapter 12 of the Private International Law Act (PILA).

Otherwise, and sometimes contrary to the parties' real intention, given the foregoing criteria, an arbitration tribunal could conclude that, as far as its jurisdiction is concerned, the controversy should be resolved by exclusively applying the provisions of Chapter 12 of the PILA (articles 176 to 199) specifically, according to article 176.1 and 2 of the PILA, regardless the national law of each of the litigant parties, unless otherwise agreed.

A decision of this sort can influence the merger transaction, because if the arbitration tribunal concludes that it has sufficient competence in the dispute, and if the dispute entails an economic interest, it will be suitable for arbitration based on the provisions of article 177.1 of the PILA. This section states that any claim of a patrimonial nature - these being understood as any claim that deals with rights having a money value for either of the litigant parties, as the Swiss Supreme Court declared in its ruling of June 23, 1992 (Ficantieri-Cantieri Navali Italiani SpA and Oto Melara, SpA) - is admissible in arbitration. A plea as to the jurisdiction of the arbitration tribunal would be very likely, and since, according to article 186.3 of the PILA, this kind of plea must be settled through a preliminary award, procedural delays and fee increases are to be expected.

5.6.2 Competition and Antitrust law Issues

Additionally, if the merger involves competition and antitrust law topics, mandatory provisions of the domestic law of the venue in these areas, if any, must be carefully studied before deciding the seat of arbitration.

Thus, a tendency noted in European countries such as France (the Labinal case), Italy (decision of the Court of Appeal of Bologna of December 1991) and Switzerland (decision of the Swiss Federal Tribunal of April 28, 1992), indicate that there is an increased acceptance of the arbitrable issues that may arise in these transactions, within certain limits. Disputes must be limited to contractual issues and therefore, will not extend to tortious behavior, including abuses of dominant position or monopoly power, except if they arise in a contractual context (e.g., validity of the contract itself, of its horizontal or vertical restraints or any damages resulting from anticompetitive behaviour) or if arbitration is agreed upon after a conflict has arisen.[166]

Conversely, in the USA, despite the Supreme Court's recognition in Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Jnc.of the arbitrability of antitrust disputes which arise from international agreements, American domestic courts have still struggled to decide whether or not domestic anti-trust disputes are arbitrable. Among the decisions against the arbitrability of domestic anti-trust disputes, American Safety Equipment Co. v. J.P. Maguire & Co. and Kotam Electronics, Inc. v JBL Consumer Products Inc. can be cited. Those cases favorable to the arbitrability of these disputes include Nghiem v NEC Electronics Inc. and Coors Brewing Co. v. Molson Breweries.

[166]Gant, Joanna, “The changing pace of Europe” Acquisitions Monthly, Feb, 2006

5.6.3 Bye laws Issues

A merger of two companies often implies that there will be the acceptance of former bylaws of the pre-existing companies or the drafting of brand new ones. In brief, the material validity of the arbitration agreement will be embedded in those corporate documents. In addition, if Switzerland is chosen as the seat for the arbitration, then article 178 of the PILA does not expressly prohibit arbitration clauses that are included in a company's bylaws.

Insofar as it refers to the material validity of the arbitration clauses contained in the bylaws of any corporation, it adheres to the doctrine contained in the decision handed down by the European Court of Justice in Luxembourg in case Powell Duffryn Pic. v Petereit.[167] In this case, the court determined that the shareholders were bound to an agreement on jurisdiction contained in the bylaws of a company, regardless of the moment at which they obtained their shares, provided that they had the opportunity to study the bylaws in good faith prior to acquiring the shares.

Based on this doctrine, the Swiss Supreme Court reached a similar decision in December 9,1997[168] confirming a partial award which based the jurisdiction of an ICC Arbitration Tribunal, amongst other documents, on the modified by-laws of one of the targeted companies.

These aforementioned examples are based on real situations that prove the importance of the selection of the appropriate seat of the arbitration by criteria other than that relating to the comfort of the parties.

[167] I ECR 1745 (1992).
[168] ATF 124 III 83.

5.7 Conclusion

The issues that have been analyzed above are only a small representation of all the topics in this area, limited by space constraints. Unfortunately, each of these topics could be an entire article on its own.

However, a conclusion can be drawn from the preceding exposition. Too often, when planning and implementing a merger deal, companies concentrate on the hard mechanics of value extension. This is the reason why companies entering into cross-border deals linking disparate corporate cultures need to concentrate in the problems of cultural integration, developing communication policies, and reward systems to reinforce change management programs.

In a globalized and sophisticated arena, apparently boundless due to the development of telecommunications, the advice of experts on different and varied fields that shape a cross-merger transaction is extremely important. This includes the involvement of experts to identify and solve the disputes that may arise from this type of arbitration.

CHAPTER6

CROSSBORDER MERGERS AND ACQUISITIONS AND COMPETITION LAW: A COMPARITIVE STUDY

6.1 Introduction

Competition policy refers to the set of laws and regulations aimed at maintaining a fair degree of competition in open markets by eliminating restrictive business practices of enterprises. The principal economic rationale underlying competition policy is that freely operating competitive markets will result in the most efficient allocation of resources and give consumers the widest variety of choices, the best quality and the lower prices.[169] Such targeted anti-competitive business practices are those which limit other enterprises from entering a market or which regulate supply in a way that is deemed harmful, either to other producers (existing or potential) or to consumers. These practices may assume a number of forms, including predatory pricing behaviour, collusion and competition-reducing mergers.

It is undisputed that, like most business moves, mergers are undertaken primarily to increase profits of participating entities. As noted above, this may come about either because the effect of the merger is to reduce competition between the participants to the merger or, where the merger leads to cost savings through the gaining of efficiencies, allowing prices to be reduced and market shares to be increased. However, mergers are often initiated for other reasons as well, such as differing future market expectations between the merging entities, tax-savings and the like. Accordingly, the fact that mergers take place

[169] Adam Smith, *An Inquiry into the ature and Causes of the Wealth of ation s,* (1776).

for a variety of reasons and that their effect upon the level of competition hi the market is not necessarily adverse suggests that a blanket rule prohibiting merger activity should be rejected in favour of a case-by-case analysis upholding or rejecting mergers depending on their precise ramifications upon the level of competitive activity.

6.2 The United States

6.2.1 Sherman Antitrust Act, 1890

In 1890, the United States Congress passed the Sherman Antitrust Act, rendering illegal arrangements designed to increase the cost of goods to the consumer. Section 1 of the Sherman Act is principally concerned with restrictive trading agreements between firms but is also generally applicable to mergers - the wording of the section, with its prohibition of "ever.... combination in the form of

trust or otherwise", being appropriate to merger control. Initially, the United States Supreme court interpreted the language of the Sherman Act to hold that all contracts restraining trade were prohibited thereunder, regardless of whether

the restraint actually produced any ill effects.[170] In the 1911 decision *of Standard*

UU Co of New Jersey v. United States, [171] however, the court developed the rule of

reason" in relation to anti-trust disputes. Stating that mere size and possession of monopoly power were *not per se* impermissible, the court laid down that only those combinations and contracts unreasonably restraining trade were proscribed under the anti-trust laws. Nevertheless, this shift in judicial reasoning did not hold sway completely for too long as the. *Standard oil rule* was narrowed in later cases

[170] See Areeda et al. *Antitrust Analysis: Problems, Text and Cases,* (2004).
[171] 221 US 1.

that held that certain kinds of restraints, such as price fixing agreements, group boycotts, and geographical market divisions, were illegal per se.

6.2.2 Clayton Act, 1914

In any case, Congress responded to these judicial developments by passing the Clayton Act shortly thereafter in 1914 to further strengthen merger control. Section 7 of the Clayton Act is specifically directed at merger control and has today become the central weapon in the merger enforcement armoury. Under this Act, the government challenges those mergers that careful economic analysis shows are likely to increase prices to consumers. Apart from enhancing governmental powers in this regard, it brought about a paradigmatic shift insofar as it permitted private lawsuits to be filed against anti-competitive practices for the first time. Unlike the Sherman Act, the Clayton Act carries no criminal penalties. The Sherman Act, specifically section-1 thereof, thus continues to provide residual possibilities for merger control enforcement.

6.2.3 Substantially Lessens Competition

Subsequent decisions handed down by the American Apex Court in this realm of law make for an interesting case study. In the *Brown Shoe* case of 1962,[172] the court noted that section 7 of the Clayton Act, which prohibits mergers where the consolidation "substantially lessens competition,...or tends to create a monopoly", protected competition and not competitors. Yet, contradicting itself, the court proceeded to state that one of the principal objectives of the enactment was the preservation of small, locally owned businesses in light of the unhealthy "rising tide of economic concentration in the American economy". This " juridical

[172]Brown Shoe co. v. United States, 370 us 294.

blunder notwithstanding, the factors to be considered in determining whether a merger would have an anti-competitive effect or not as laid down by the court in what remains a seminal decision are of profound importance. The following criteria are to be applied, namely, any tendency towards concentration in the relevant market, the likely failure of the firm to be taken over, possible benefits of mergers among smaller firms in markets dominated by larger ones, and market share of the horizontally merged entity. The very next year, the Supreme Court elevated the market-share factor to a rule of presumptive

illegality in the *Philadelphia ational Bank* case,[173] wherein it was held that a merger which produced a firm controlling an undue percentage share of the market and resulting in a significant increase in the concentration of firms in the market would be presumed to be anti-competitive. Commentators note that this structural approach to merger analysis dominated judicial enforcement of section 7 of the Clayton Act until evidence was allowed to be adduced to rebut the above presumption raised by substantial market share in the 1974 case *of General*

Dynamics[174]Today, the rule of presumptive illegality continues to apply, but can be rebutted by adducing a variety of evidence relating to the relevant market to the effect that the merger will create significant efficiencies that will enhance competition, and benefit consumers. The courts must then weigh these competing possibilities and decide whether to allow the merger of not. While this legal position has enhanced scope for litigation, it is equally true that American courts are now more determined to assess the real impact of a merger after detailed investigation rather

[173] *United States* v, *Philadelphia ational Bank,* 374 US 321.

[174] *United States* v. *General Dynamics,* 415 US486.

than its supposed impact based •exclusively on economic extrapolations from market share data.

6.2.5 Guidelines on Merger Control Policy

The Antitrust Division of the Department of Justice has issued Guidelines on its merger control policy. In contrast to the conventional tripartite categorization, these Guidelines deal with mergers in two broad categories - non-horizontal and horizontal. While the former set has been formulated by the Department solely, the latter has| been issued jointly with the Federal Trade Commission.[176] These Guidelines outline the analytical framework and specific standards applied in the present enforcement policy of the Department of Justice and the Federal Trade Commission, subject of course to the relevant statutory provisions and judicial interpretation thereof. By stating the policy as simply and clearly as possible, the bodies hope to reduce the uncertainty associated with enforcement of the antitrust laws in this area. Nevertheless, the standards of the Guidelines are not invoked mechanically hut reasonably and flexibly to the particular facts and circumstances of each proposed merger.

[175] The Antitrust Division of the Department of Justice is a prosecuting arm United States government whereas the Federal Trade Commission is independent agency thereof. Both bodies are entrusted with the missions of promotion of consumer protection and the elimination of anti-competitive business practices. The concurrent jurisdiction of the two agencies has potential for conflict but the relationship is one of friendly competition rather than antagonism. There is an effective co-ordination procedure to ensure that both agencies do not investigate the same case. In certain cases, prior notifications of mergers have to be mandatorily given to both agencies under law. Following the Hari-Scott-Rodino Antitrust Improvements Act, 1976,'a company seeking to acquire or merge with another company must file advance notice of its intentions with both agencies if the transaction exceeds certain thresholds.

6.2.6 Horizontal Merger Guidelines

The unifying theme of the Guidelines is that mergers should not be permitted to enhance market power or facilitate its exercise. The pattern of analysis described in these Guidelines involves several components. The five-part structure detailed in the Horizontal Merger Guidelines, for instance, comprises: one, the quantitative presumptions of "market share" and "concentration" ; two, potential adverse competitive effects; three, entry analysis; four', efficiencies; and five, failing and exiting assets.

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[176]*See* the Non-Horizontal Merger Guidelines (originally issued as part of the "us Department of Justice Merger Guidelines") issued by the us Department of Justice as of 14th June, 1984.

6.2.8 Merger Creating RearMonopoly ot Permitted

If in any particular merger situation, the quantitative analysis does confirm potential anti competitive effects, mitigating factors would then be considered to reach aholistic conclusion. The most common route employed in

this regard is the"efficiency" defence.[177] Every merger has the potential to generate significant efficiencies by permitting a better utilization of existing assets, and by enabling the combined firm to achieve lower costs in producing a given quantity and qualify of goods. However, only "merger-specific" efficiencies, namely those efficiencies that are unlikely to be accomplished in the absence of the proposed merger, are allowed to be adduced as a defence. Efficiencies are difficult to verify and quantify, in part because much of the If information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realised.

Therefore, the merging firms must elaborate upon efficiency claims in detail so that they can be verified independently. This leads to the ascertainment of

[177] Paragraph 4 of the Horizontal Merger Guidelines issued jointly by the us Department of Justice and the Federal Trade Commission as of 2nd April, 1992 (partially revised on 8th April, 1997).

"cognisable" efficiencies, namely those merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service. Ultimately, the efficiency defence would have been invoked successfully if the merger analysis confirms that the cognisable efficiencies are of such a character and magnitude that the merger is not likely to be anticompetitive in any Irrelevant market. It must also be noted that efficiencies alone cannot save otherwise objectionable merger. This is the reason why a merger creating a monopoly or near-monopoly is never permitted, notwithstanding the massive efficiencies they invariably generate.

6.2.9 Entry Analysis and Failing Firm Defences

That the potentially anti-competitive outcome would actually be offset in view of specific qualitative factors, such as "entry analysis" and "Tailing firm" defences, are also considered. To successfully establish an "entry analysis" defence, the merging entities must show that they would be unable to raise their prices to above that of the market level through the exercise of their market power as at that higher price, newer firms would enter the market to compete and thereby counterbalance the merger firm's market power. To successfully establish a "failing firm" defence, the merging entities must prove three propositions: *first*, the allegedly failing firm would in the near future be forced out of the market because of financial difficulties if not taken over by another under-|taking; *second,* there is no less anti-competitive alternative to the proposed merger; and *third,* in the absence of the merger, the assets of the failing firm would exit the market thereby causing massive harm to
consumers.[178]

[178]Paragraph 5 of the Horizontal Merger Guidelines issued jointly by the l« Department of Justice and the Federal Trade Commission as of 2nd April, 1992 (partially revised on 8th April, 1997).

6.3 United Kingdom

6.3.1 Public Interest

Statutory regulation of mergers in the United Kingdom has been subject to frequent legislative interference. To begin with, there was no provision for control of mergers till the Monopolies and Mergers Act was enacted in 1965. The said Act had a short life span, lasting a mere eight years before being replaced by the Fair Trading Act in 1973. This later enactment lasted longer, forming the backbone of merger control in the United Kingdom for early three decades,[179] although it too was subject to substantial amendments by the Companies Act in 1989 and the Contracting Out and Deregulation Act in 1994. Nevertheless, this merger control regime suffered from various drawbacks and was subject to severe criticism. Primary amongst them were the grave legal uncertainty due to the ambiguously worded "Public interest" test in judging the acceptability of any merger and the excessive involvement of the Secretary of State in decision-making opposed to independent competition authorities.

6.3.2 Shift to Professionalized Competition Regulation

The British Parliament accordingly passed the Enterprises Act in 2002, introducing an altogether new regime .for merger control in the United Kingdom. From a institutional perspective, the Act removed government ministers from the process of judging the acceptability of mergers in all but the most exceptional cases, and transferred the responsibility to determine merger cases to competition authorities. From a substantive perspective, the "public interest" test against which mergers were previously assessed was replaced by a purely competition-based test. The Act provided for publication of detailed statement of reasons in all merger cases,

[179]Richard *Whish, Competition Law* (2001) at 803.

with a right of appeal to specialist competition tribunal. Thus, the thrust of this new legislation *was* to not only move towards a professionalized competition regulation regime but also induct greater procedural expediency and objective economic indicators in the regulation of mergers.

6.3.3 Commission's Power to Remedy Situation

Once reference is made to the Competition Commission, it has to confirm whether a particular merger situation is anti-competitive.[180] The 'substantial lessening of competition', test is applied at such a stage. This test is based on various factors that an given varying degrees of weightage depending on the details of a given case. But the predominant considerations remain economic ones. There are also various 'efficiency claims' that can be advanced by the merging entities to offset the factors used to show that the merger is anti-competitive. These claims must be demonstrable, must arise out of the merger and the benefit must be likely to be passed onto the customers.[181] If the Commission comes to the conclusion that a merger would have an anti-competitive outcomes is provided with wide ranging powers to remedy the situation.[182]

6.3.4 Different Parameters for Different types of Mergers

It is relevant to note that though the broad 'public interest' test under the previous legislation has been done away with in favour of the 'substantial lessening of competition' test, public interest considerations have still not been

[180] Sections 35, 36, Enterprise Act, 2002.

[181] Paragraphs 3.11 to 3.34 of the Office of Fair Trading Substantive Assessment Guidelines on Mergers (OFT516),available at *http://www.oft.gov.uk.*

[182] Section 41(2) Enterprise Act, 2002 provides that the Competition Commission has a duty to take such action as is reasonable, or practicable to remedy, mitigate, or prevent the substantial lessening of competition. But uniformity in decision making (section 41(3)) and customer benefit (section 41(5)) are factors that are to be kept in mind. The Competition Commission has listed the various remedies in paragraph 4.18 of the Merger References: Competition Commission Guidelines, available at *http:/Jwwu>.competitioncommission.org.uk.*

completely , eliminated.[183] Further, different parameters have been provided for horizontal, vertical and conglomerate mergers.[184]

6.4 India

In the pre-liberalization era, companies or undertakings proposing to merge or amalgamate were mandatorily required to obtain prior approval of the Central Government.[185] Mercifully, from a business perspective, the said provision was discarded by the 1991 amendment to the Monopolies and Restrictive Trade Practices Act, 1969. Yet, the Monopolies and Restrictive Trade Practices Commission and the Central Government retained the power to control and regulate mergers and amalgamations if they were found to be prejudicial to public interest.[186] This legal proposition found judicial recognition in the 1995 case *of Hindustan Lever Employees Union* v. *Hindustan Lever Ltd.*[187] where the Supreme Court of India held that "....a merger or amalgamation is now not subject to the prior approval of the Central Government. But if the working of the company is found to be prejudicial to public interest or has led to the adoption in monopolistic or restrictive trade practice, the Central Government may, after being satisfied as to the requirement of the section or division of the undertaking, act according to law."[188] Thus, the Central Government could .direct the companies not to effect the transfer if, as a result of the transfer, a change in

[183]Sections 42 to 58 of the Enterprise Act, 2002.

[184]Chapters 4,5 and 6 of office of Fair Trading Substantive Assessment Guidelines on Mergers (OFT 516) deal with horizontal mergers, vertical mergers and conglomerate mergers respectively.

[185]Section 23, Monopolies and Restrictive Trade Practices Act, 1969.

[186]Sections 27, 27A, Monopolies and Restrictive Trade Practices Act, 1969.

[187]*Hindustan Lever Employees Union v..Hindustan level ltd., AIR 1995SC471.*

[188]*Ibid.* The Supreme Court, however, rejected the argument that the merger in question was against public interest on facts as there was no detriment to consumers and the employees had been adequately provided for.

the controlling interest is likely to take place which would be prejudicial to the interest of the company or to the public interest at large.[189] Further, provisions of the Companies Act, 1956 whereunder approval of the Central Government is necessary before transfer or acquisition of snares can take effect in certain circumstances could also be summoned in this regard to control merger situations.[190] But none of these provisions potentially related to merger control provided for the specific examination of the effect on the level of competitive activity of such acquisition or transfer of shares. Even section 394 of the Companies Act, 1956, which gives the court the power to "regulate mergers, has never been employed to block a merger on the ground that is in restraint of competition.[191]

6.4.1 Competition Act, 2002

Thus, there existed some uncertainty as to whether *a* merger could .even he tested on the touchstone of competition policy concerns given the existing legal regime. Need was felt for statutory provisions that unequivocally permitted, indeed demanded, the examination of repercussions of mergers upon competition concerns. This need was particularly acute in the context of pre-empting the potential abuse of dominant market position where such abuse appears probable even before the merger actually takes place.[192] The Competition Act, 2002 was enacted in response to this need, dealing extensively with merger activity and their effect on competition issues.

[189] Section 108D, of the Companies Act, 1956.

[190] Sections 108A to 1081, of the Companies Act, 1956.

[191] *Larsen and Toubra Ltd., In, re.* [2004] 121 Comp Gas 523 (Bom).

[192] Report of High Level Committee on Competition Policy and Law, 2000 at paragraph 4.6.1. As per the Committee, separate provisions are required "to preempt the potential abuse of dominance where it is probable, as subsequent unbundling can be both difficult and socially costly."

6.4.2 Combinations as Distinct From Mergers

The 2002 enactment uses the term 'combination', a concept potentially wider that a merger *stricto senso,* for it would also encompass all acquisition of control, shares, voting rights and assets beyond a certain level. Further, it prescribes a monetary threshold above which the Competition Commission is required to study the effects of the 'combination'.[193] A fairly high limit has been set because it has been recognized that Indian companies need to grow to attain the economies of scale to compete in the global arena.[194] All combinations have to be notified to the Competition Commission.[195] The Commission may investigate any combination if it is of the 0pinion that it is likely to cause, or has caused, an "appreciably adverse" effect on competition within the relevant market in India.[196] The Commission may direct certain modifications be carried out if it concludes that any such potentially adverse effect can be eliminated by suitable modification to such combination.

6.4.3 Would the 'Substantial Lessening' or 'Significantly Impeding' Tests be Preferable?

While the passage of the Competition Act, 2002 in India is undoubtedly a welcome step, potential problem areas have been left unadressed. *One,* while the Act does lay down various factors that have to be considered by the Competition Commission to determine whether a combination has resulted in an "adverse effect on competition", scope does remain for confusion to arise given the newly-coined wording of the test. A better approach to take could possibly have been incorporating the "substantial lessening of competition" test as has been adopted in the United States and the United Kingdom. Even the European Community

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[193] Section *5* of the Competition Act, 2002.
[194] Report of High Level Committee on Competition Policy and Law, 2000 at paragraph 3.9.
[195] Section 6(2) of the Competition Act, 2002.
[196] Section 29 of the Competition Act, 2002.

Merger Regulations incorporates facets of the "substantial lessening of competition" test in its "significantly impedes effective competition" yardstick. Doing, so would have been advisable as the "substantial lessening of competition" test rests on an extensive body of case law in the legal systems detailed above where its application to different factual matrices has been elucidated upon ' at some length. Applying those precedents in the Indian context would have been apposite given that Indian judges frequently turn to the said legal systems for inspiration even in other areas of law. And *two,* most of the complications in the merger control process arise at the stage of implementation of policy. In this regard, it remains to be seen whether the Competition Commission, as and when it starts examining mergers, follows a teleological approach in preference to pedantic application of strait-jacket formulas. Like the Raghavan Committee, whose recommendations formed the basis of this Act, the Commission too must draw inspiration eclectically from various competition jurisdictions in dealing with different merger situations. Ultimately, however, the decisions it reaches must be ones that weigh the costs and benefits of allowing the mergers to fructify.

6.5 Competition Policy and the WTO

Globalisation has resulted in the internationalisation of business activities and thereby brought about an increase in multi-jurisdiction competition law violations. This has prompted leaders of the business community to call for the harmonisation of competition laws of different municipal jurisdictions, as regards substantive as well as procedural aspects. These demands are eminently reasonable, especially in the context of transjurisdictional mergers. Companies involved in such mergers must prepare voluminous documents of different formats to respond to demands from different countries. When faced with

conflicting decisions, they may have to give up the attempted merger altogether due to reasons entirely extraneous to pure business considerations. Even enterprises that do manage to triumph over these hurdles and successfully merge may later be accused of monopolisation or abuse of a. dominant position, and accordingly be subject to incompatible remedies bydifferent-countries. Yet, despite these massive discrepancies in merger standards in different municipal jurisdictions, as indeed in other aspects of competition law, the only area where there is universal consensus is condemnation of "hard-core cartels". This leads one to pessimistically conclude that broad harmonisation of the substantive content of competition law is simply unattainable.

6.5.1 Difficulties in Arising at a Competition Policy in Global Enviornment

Developments at World Trade Organisation Ministerial Conferences as regards formulating an Agreement on Competition Policy along similar lines as those on Intellectual Property Rights, Investment Measures -aid so on only appear to affirm the above bleak thesis. The World Trade Organisation Ministerial Conference of 1996 in Singapore established a Working Group on irade and Competition to eliminate trade barriers created by anti-competitive corporate conduct Yet, despite repeated attempts to make progress on the matter, notably during the World Trade Organisation Ministerial Conference of 2003 in Cancun, disagreements between largely developed and developing economies have prevented progress on the issue.

6.5.2 Market Access Issues Causing more Concern than Competition Problems

In fact, from the point of view of developing countries, it is dubious whether a comprehensive, uniform WTO-based Agreement is necessary or even desirable. Undoubtedly, the benefits of such an agreement would possibly be in the ability to temper the anti-competitive activities of transnational corporations. yet, the costs, in the form of restrictions on the countries' freedom to run targeted industrial policies and nurture domestic producers with a view to strengthening national economic clout, are bound to be inevitably greater. Further, such an agreement is likely to be dominated more by market access issues than core competition law concerns as the WTO process is driven by trade interests and not national welfare considerations. Consequently, there is no assurance that the rules ultimately proposed will be welfare enhancing. It is theorised that such countries would be better advised to develop their own municipal competition law regimes, drawing upon the experiences of developed countries in doing so when the latter were in a similar position.

6.6 Conclusion

Uniformity in standards in different countries are unlikely to be achieved through WTO in the near future. As this study of selected legal jurisdictions has documented, the competition law regimes pertaining to merger control in different jurisdictions are in various stages of flux. In the United States of America, detailed judicial precedents and established regulatory mechanisms exist in this regard. In sharp contrast, in the United Kingdom, the European Economic Community as well as India, the statutory/regulatory provisions pertaining to merger control have been subject to varying degrees of overhaul in recent times. Further, each of these jurisdictions displays unique processes and standards of merger control. The assertion that the differences in question would be innumerably greater on a world-

level is indisputable. That coupled with the fact that some countries lack a competition law regime altogether indicates the over-arching need for a unified, cross-jurisdictional standard on competition policy. Only then can anticipated exponential increases in merger-related competition law concerns in a rapidly globalizing business environment be effectively tackled, Yet, WTO-driven efforts to formulate such a standard seem unlikely to attain any success in the near future.

CHAPTER7

COCLUSION & SUGGESTIONS

The cross-border mergers and acquisitions are becoming a more prevalent feature of the Indian corporate landscape. There is increasing importance of businesses, and cross-border transactions have become the quick-vest way of achieving their objective in global market place. It is expected that this trend will continue as the world becomes smaller and as the growth opportunities for local players continue to be limited by the size of the Indian market. Critically, when an Indian company considers a foreign acquisition it needs to ensure that all the bases and risks are covered, both that arise in any acquisition, and those which arise by virtue of doing a deal in unfamiliar territory.

The entire world over, cross-border transactions by companies have been increasing. While 2005 saw a total of 329 deals valued at $17 billion, 2006 witnessed approximately 390 deals but with the value nearly double of the previous year ($32 billion), while the merger worldwide for the first half of 2007 totalled US $2.7 trillion, which is 67 per cent higher than 2006 first half total, and it surpassed the previous first-half record of US$1.93 trillion set in 2000. It has been also, observed that cross-border activity accounted for a record-breaking 47.5 per cent of worldwide merger and acquisition ('M&A') activity for the first half of 2007 as global consolidation continued to drive activity in the financials, materials, and energy and power sectors.

Finalizing an acquisition requires that various transactional issues be discussed, negotiated, finally agreed upon and properly reflected in the

definitive purchase agreement. The representations and warranties of the company to be acquired and of the seller- especially the representation that full disclosure has been made to the acquirer—are an important part of that agreement from the acquirer's perspective, whether or not the transaction involves a cross-border Indian acquisition. The seller will seek to qualify its representations and warranties to reflect what has come to light in the due diligence exercise. India being a country with a vast number of laws, it is necessary for a foreign acquirer to have the comfort of knowing to what extent the target company has been in compliance with those laws ; moreover, the acquirer will want full disclosure of those matters as to which there has not been compliance. As for the issue of the post-closing survival of representations and warranties, it is typical for the parties to agree to a survival period of between three and four years.

As for the issue of indemnity, the concepts of de minimize liability for which there is no recourse and of an overall cap on potential liability, as well as requiring a minimum threshold or basket amount before the seller can be held liable, are concepts that may be put forward by the seller to reduce its exposure to a certain extent. In the negotiation of such liability limits, it is essential for the acquirer (who, of course, will seek a blanket indemnity without any limits or caps) to keep in mind the local laws of the relevant country and the type and value of the claims that may arise. Conditions precedent to closing are essential in addressing and ensuring that all approvals and consents have been obtained to allow the transaction to be consummated. Moreover, conditions precedent to closing that involve curing any problems that

were discovered during the due-diligence reviews help to ensure that the acquirer will not also acquire those problems at closing.

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