The Year That Was For M&A, PE & VC

In 2024, the legal landscape for equity and debt investments in India underwent significant changes. Compared to a relatively dull 2023, the deal landscape for India in 2024 showed considerable improvement, more so against a temperate global scenario. The last 12 months saw the implementation of some impending changes such as mandatory dematerialization of shares of private companies, the short-term impact of which was and continues to be, a delay in closing timelines. The revamp of the Indian merger control regime also came into effect in September 2024 with the implementation of the deal value threshold concept, reduced timelines for the Competition Commission of India to approve applications, codification of green channel rules, etc. These changes were intended to make deal-making more efficient, with stronger internal control expectations, to build upon the idea of making India a more attractive investment destination. This write-up explores the key legal updates in the transaction space in India in 2024 and offers practical consequences of such changes.

Cross-border share swap permitted by RBI

Prior to August 16, 2024, only issue of equity instruments (i.e. equity shares, convertible debentures, preference shares and share warrants) by an Indian company was permitted against swap of equity instruments. Accordingly, secondary share swaps wherein there is a transfer of shares of an Indian company against shares of an Indian company or a foreign company was not permissible.

This restriction was lifted in August 2024 by way of Foreign Exchange Management (Non-Debt Instruments) Fourth Amendment Rules, 2024 ("**2024 NDI Rules Amendment**")[1] and transfer of equity instruments of an Indian company between a person resident in India and a person resident outside India is now permitted against (i) a swap of equity instruments; as well as (ii) a swap of equity instruments of a foreign company (subject to compliance with the Foreign Exchange Management (Overseas Investment) Rules, 2022 ("**OI Rules**")), without requiring any approval for such swap. However, prior Government approval is required for all transfers in cases/sectors where Government approvals are otherwise required. It is pertinent

[1] https://static.pib.gov.in/WriteReadData/specificdocs/documents/2024/aug/doc2024816377701.pdf

to note that the rules specify that the swap arrangement would be subject to regulations specified by the Reserve Bank of India ("**RBI**") and Central Government, both of whom are yet to notify any regulations in this regard.

Needless to say, such swaps are subject to pricing guidelines set out under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 ("**NDI Rules**"), and valuation for such shares will have to be done by a Merchant Banker registered with the Securities and Exchange Board of India ("**SEBI**") or an investment banker outside India registered with the appropriate regulatory authority in the host country.

From a tax perspective, a share swap is treated as a 'transfer' under Section 2(47) of the Income Tax Act, 1961 and would be chargeable to tax in India, subject to any available treaty benefits. However, any share swap undertaken pursuant to a scheme of amalgamation or reorganization (including merger or demerger) would be exempt from such taxation.

While the 2024 NDI Rules Amendment is a major boost clarifying a long-sought position in law and should help facilitate cross border transactions for Indians, we still await clarity on how foreign-owned or controlled companies and their downstream investments would be treated for share swap transactions, as well as clarity vis-à-vis the OI Rules on a swap of equity instruments by Indian resident individuals in exchange for equity capital of a foreign company which continues to be permitted only pursuant to a merger, demerger or amalgamation.

<u>Reverse flipping of foreign holding company into Indian wholly owned subsidiary</u>

In the recent past, a few notable companies which were situated abroad have been returning their domicile to India by merging the foreign company with its wholly owned subsidiary in India. Recognizing this momentum, the Ministry of Corporate Affairs has streamlined the process of reverse-flipping and now, inbound cross-border reverse mergers fall under the fast-track merger route under Section 233 of the Companies Act, 2013[2].

However, such inversions are contingent on both the foreign holding company and the Indian wholly owned subsidiary obtaining prior approval from the RBI. However, if (a) the reverse-flip is eligible for deemed RBI consent under the Foreign Exchange Management (Cross Border Merger) Regulations, 2018, and (b) the reverse-flip does not require RBI consent pursuant to

[2] Introduced by amending Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 effective from September 17, 2024.

the PN3 circular[3], then no RBI consent may be needed for the reverse-flip. A specific declaration must be filed under Rule 25A(4) if the foreign holding company is situated in a country that shares a land border with India. Further, the reverse-flip structure should adhere to the processes for fast-track mergers, including applying to the Regional Director for approval.

By aligning with the existing provisions of Section 233 of the Companies Act, 2013, that already allows mergers between a holding company and its wholly owned subsidiary, the amendment effectively facilitates smoother and faster cross-border restructuring for businesses. Further, the ability to bypass National Company Law Tribunal ("**NCLT**") approval will help streamline the process of inbound cross-border reverse mergers and help in reduction of both time and costs involved.

However, one of the issues that has arisen with this amendment is that it creates a little ambiguity with the existing law wherein (a) while Rule 25A(5)(iii) imposes a mandatory obligation to follow the fast-track merger process [*usage of the term 'shall'*] and (b) Section 233(14) of the Companies Act, 2013 states that a company covered under Section 233 may use the provisions of Section 232 of the Companies Act, 2013 for the approval of any scheme for merger or amalgamation. This would mean that the parties under Section 233 have an option to approach the NCLT also for such merger if required for any reason whatsoever. However, this option seems to be missing in Rule 25A(5)(iii), which mandates that the parties have to use the fast-track merger process only. We will have to wait and see how this would be interpreted.

Major overhaul to the merger control regime

In September 2024, the Ministry of Corporate Affairs notified the Competition (Amendment) Act, 2023, along with certain corresponding rules, paving the way for the impending overhaul to the merger control regime. The key amendments are set out below:

- Introduction of the concept of deal value threshold, whereby all transactions where the value of the transaction (including direct, indirect, immediate and deferred consideration) exceeds INR 2,000 crore, and the target has 'substantial business operations' in India, will require prior approval from the Competition Commission of India ("**CCI**"), even if they can otherwise benefit from the de-minimis exemption.

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[3] https://dpiit.gov.in/sites/default/files/pn3_2020.pdf

- The concept of 'control' has been expanded to include 'material influence' over affairs or management or strategic commercial decisions of an enterprise.

- The green channel route has now been codified, whereby certain transactions which require to be notified to CCI can be considered to be deemed approved the day, the filing is made. Relatedly, there is a key change to the definition of 'affiliates' that will impact overlaps assessment. The definition of affiliates has been expanded to include in its scope, the right/ability to access commercially sensitive information of an entity.

- The CCI is required to form a prima facie opinion on a combination within 30 (thirty) calendar days and in the event that the CCI does not form a prima facie opinion within this timeline, the combination shall be deemed to have approved. A combination, upon notification to the CCI, shall be deemed approved upon expiry of 150 days (as opposed to the earlier 210 days), if the CCI does not pass any order by that time.

While the revamp of the Indian merger control regime brings along the promise of quicker approvals, the introduction of additional criteria like the deal value threshold and revisions to the concepts of 'affiliates' / 'control', make it essential to reassess the notifiability of transactions and reconsider how future deals are to be assessed.

<u>Increased scrutiny on NBFC compliances, cancellation of CORs</u>

Following up on the intent shown by the RBI in 2023 to intensify regulatory audits of non-banking financial companies ("**NBFC**"), the year 2024 saw further audits and also resulted in actions taken by the RBI, both in terms of penalties and cancellation of registrations.

The RBI has levied monetary penalties for non-compliance with know-your-customer ("**KYC**") guidelines, cybersecurity guidelines, liquidity risk management frameworks, etc. The monetary penalties levied by RBI on NBFCs for non-compliances has increased substantially in the last 3 years. The year also saw RBI cancel the certificate of registrations of some NBFCs. While the RBI press releases do not mention the reasons for the cancellation, KYC and anti-money laundering violations seem to be the top reasons for such cancellations.

One of the surprising developments this year across NBFCs has been the discomfort of RBI with the concept of board observers. The concept of 'board observers' is quite standard in private equity deals, whereby a private equity investor gets a right to appoint an observer who can attend board meetings without voting rights. RBI's view on this appears to be that while an observer is entitled to the rights of directors, he is not subject to the obligations of directors and further, gets access to confidential information regarding the NBFC. The RBI has directed multiple NBFCs to remove their board observers. This may lead to interesting developments in the space of private equity investments in NBFCs, particularly whether investors choose to have a director nomination right or they choose to stay away from the board completely, since appointment of directors in NBFCs may require RBI consent and even where RBI consent is not needed, directors will, in all cases, need to comply with the 'fit and proper criteria' set out by the RBI.

The year ended with further concerns for NBFCs with off-shore parent entities, with the Income Tax Department having sent notices to several NBFCs, under Section 133 of the Income Tax Act, 1961, questioning the nature of transactions between the Indian subsidiary and the foreign parent company, from the lens of moving a major chunk of profits earned from these businesses in India as service fees to the foreign parent company.

Self-regulation for fintech

The RBI released the draft framework for recognising Self-Regulatory Organisations for the fintech sector ("**SRO-FT**") on January 15, 2024[4]. The framework introduces self-governance in the fintech space to adhere to industry standards, while maintaining a balance between innovation and compliance with applicable laws and regulations. The framework prescribes the membership criteria, SRO-FT structure, application requirements, functions, and governance framework. Some of the key aspects covered under the framework are set out below:

- The applicant should be set up as a not-for-profit company registered under Section 8 of the Companies Act, 2013. The shareholding of the SRO-FT should be sufficiently diversified, and no entity should hold 10% or more of its paid-up share capital, either singly or acting in concert.

- Membership of the SRO-FT should comprise of members who are FinTechs, and membership should be voluntary.

- The functions of SRO-FT include, *inter alia*, aspects such as guiding the conduct of its members, ensuring that they adhere to industry standards, complying with relevant laws and regulations, and maintaining high ethical standards.

[4] https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=57127

- The responsibilities of SRO-FT towards the RBI include, *inter alia*, aspects such as playing a pivotal role in ensuring compliance with statutory and regulatory frameworks, adherence to industry standards and best practices, etc.

With the RBI already having identified a couple of SRO-FTs, self-regulation, if done right, can go a long way in balancing innovation in the fintech sector, coupled with the protection of consumer interest.

<u>Broad interpretation of the term 'employee' under the POSH Act: The OLA judgment</u>

The Hon'ble High Court of Karnataka, in its ruling, in the matter of Ms. X v. ANI Technologies Private Limited & Others, considered whether cab drivers qualify as 'employees' under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 ("**POSH Act**"), and whether ANI Technologies Private Limited ("**OLA**") can be classified merely as an 'intermediary'.

The court observed that the subscription agreement between OLA and the drivers clearly outlined the scope of service, manner and method that the driver must adopt while rendering the services. Since OLA maintained management, supervision, and control over how the driver delivers these services, even though the subscription agreement referred to the drivers as independent contractors, the court noted that the drivers lacked the ability to take independent decisions with respect to performance of services and also that to advance the purpose and intent of the POSH Act, the 'employee' definition will need to be expanded to include persons employed on a contract basis and/or a contract worker. Given the clauses of the subscription agreement and the admitted position that the vehicle belonged to OLA's group companies, the court concluded that, for the purpose of the POSH Act, the driver is an 'employee' of OLA, which cannot be regarded merely as an 'intermediary'.

While the case is pending appeal before the Division Bench currently, the principles laid out under this judgment should be seen as limited to the interpretation of employees under the POSH Act, which is broader than the concept of 'employees' under other labour laws. However, the judgment is likely to make companies re-assess their obligations with respect to gig workers, especially in the context of sensitive matters like sexual harassment.

<u>Increasing clamp down on identification of significant beneficial owners: The LinkedIn judgment</u>

Through a significant part of 2024, the Registrar of Companies ("**ROC**") in several jurisdictions, issued notices to several companies, especially the ones that have received foreign investment, calling upon them to comply with their obligations in relation to identification of 'significant beneficial owner' ("**SBO**") under Companies Act, 2013. While there are no written circulars in this regard, the ROC's focus arguably seems to be on opaque holdings structures that are often used by venture capital / private equity funds.

One of the by-products of this clamp down was also the levy of penalty on LinkedIn and its founders for non-compliance with SBO identification obligations. Since LinkedIn India had identified LinkedIn Corporation as its holding company, even though LinkedIn Corporation was not present in the upstream layers of the LinkedIn corporate structure, the ROC held that LinkedIn Corporation can be regarded as the holding company of LinkedIn India only on account of exercise of control on the composition of the board of directors of LinkedIn India. Accordingly, the ROC held that the CEO and President of LinkedIn Corporation, Mr. Ryan Roslansky along with his reporting superior, Mr. Satya Nadella, are SBOs of LinkedIn India on account of their ability to exercise control over LinkedIn India.

The ROC rejected the argument that employees of Microsoft Corporation and LinkedIn Corporation who are directors on the board of LinkedIn India cannot be considered as nominees of Microsoft Corporation and LinkedIn Corporation, since they do not take any remuneration for this role, and they resign from their directorship once they exit the parent entity. Further, the ROC observed that the control of financial transactions of LinkedIn India also vests with Mr. Satya Nadella, as the CEO.

The ROC order in the LinkedIn matter has notably expanded the interpretation of 'significant beneficial owner' and could have ramifications on the way employment agreements with senior employees are drafted going forward, along with disclosures of holding companies under financial statements.

<u>FEMA Compounding: Monetary limits increased</u>

In September 2024, the Government notified the Foreign Exchange (Compounding Proceedings) Rules 2024 ("**2024 Compounding Rules**")[5], with the intent to simplify, both from the perspective of administration and time, the process of compounding minor non-compliances. The key changes brought about by the 2024 Compounding Rules are set out

5 https://static.pib.gov.in/WriteReadData/specificdocs/documents/2024/sep/doc2024912392301.pdf, in supersession of erstwhile Foreign Exchange (Compounding Proceedings) Rules, 2000

below:

Change in monetary limits: The monetary limits on the sum involved in contravention, which determines the powers of RBI compounding officers to compound the contraventions have been increased in the 2024 Compounding Rules.

Amount involved in the contravention	**Officers who can compound the contravention**
Not exceeding INR 60 lakhs	an officer not below the rank of the Assistant General Manager of the Reserve Bank
Not exceeding INR 2 crore 50 lakhs	an officer not below the rank of the Deputy General Manager of the Reserve Bank
Not exceeding INR 5 crore	an officer not below the rank of the General Manager of the Reserve Bank
Exceeding INR 5 crore	an officer not below the rank of the Chief General Manager of the Reserve Bank

Procedural changes: Compounding fees and penalties can now also be paid NEFT (in addition to payment via demand drafts) and compounding authorities are permitted to require the applicant to take necessary actions with respect to transactions involved in the contravention without having to return the application.

Security interest for dissenting secured financial creditors: The Paridhi Finvest judgment

The Hon'ble Supreme Court of India, in the matter of Paridhi Finvest Private Limited *v.* Value Infracon Buyers Association & Anr*,* upheld the order of the National Company Law Appellate Tribunal, New Delhi ("**NCLAT**"), observing that secured dissenting financial creditors ("**SDFCs**") cannot demand that the pay-out of their outstanding debt be linked to or be based on the value of the security interest that is created in their favour, but instead will need to be subject to the distribution waterfall provided for under the Insolvency and Bankruptcy Code, 2016 ("**IBC**"). The resolution plan was approved not only by the committee of creditors ("**CoC**") with a 90.45% vote, but was also sanctioned by the National Company Law Tribunal, Delhi on April 28, 2022. The appellant challenged the resolution plan, contending that the proposed pay-out amount was inadequate to cover the value of the security interest charged in its favour.

The NCLAT, relying on the Supreme Court's judgment in India Resurgence ARC Private Limited *v.* Amit Metaliks Limited, rejected the appellant's arguments and held that an SDFC is entitled to only such amounts, as is determined basis the distribution waterfall set out under Section 53(1) of IBC and will not be entitled to any right/preference over the other financial creditors. The NCLAT also referred to its ruling in ICICI Bank Limited *v.* BKM Industries Limited, reaffirming that the CoC's decision to distribute proceeds proportionate to admitted claims aligns with the provisions prescribed by the IBC.

Conclusion

Basis the regulatory and legal changes we've seen in 2024, it is clear that the Government wants to continue on its aim of making deal making easier in India along with tightening the screws on governance and misuse.

With the conclusion of the central elections in 2024, and there not being absolute single party majority at the center, it is reasonable to expect that policy making may be impacted slightly as a result of various stakeholders involved. Stand alone, from an economic perspective, India in 2024, has made significant strides in global rankings, becoming the 5th-largest economy and climbing to 39th in the Global Innovation Index. Even with the steps that have already been taken, there remains a pressing need for continued policy and economic reforms to further enhance regulatory clarity, foster innovation, and drive sustainable growth in an increasingly competitive global market.

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