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M&A in International Arbitration
An Indian perspective

Contents

Introduction

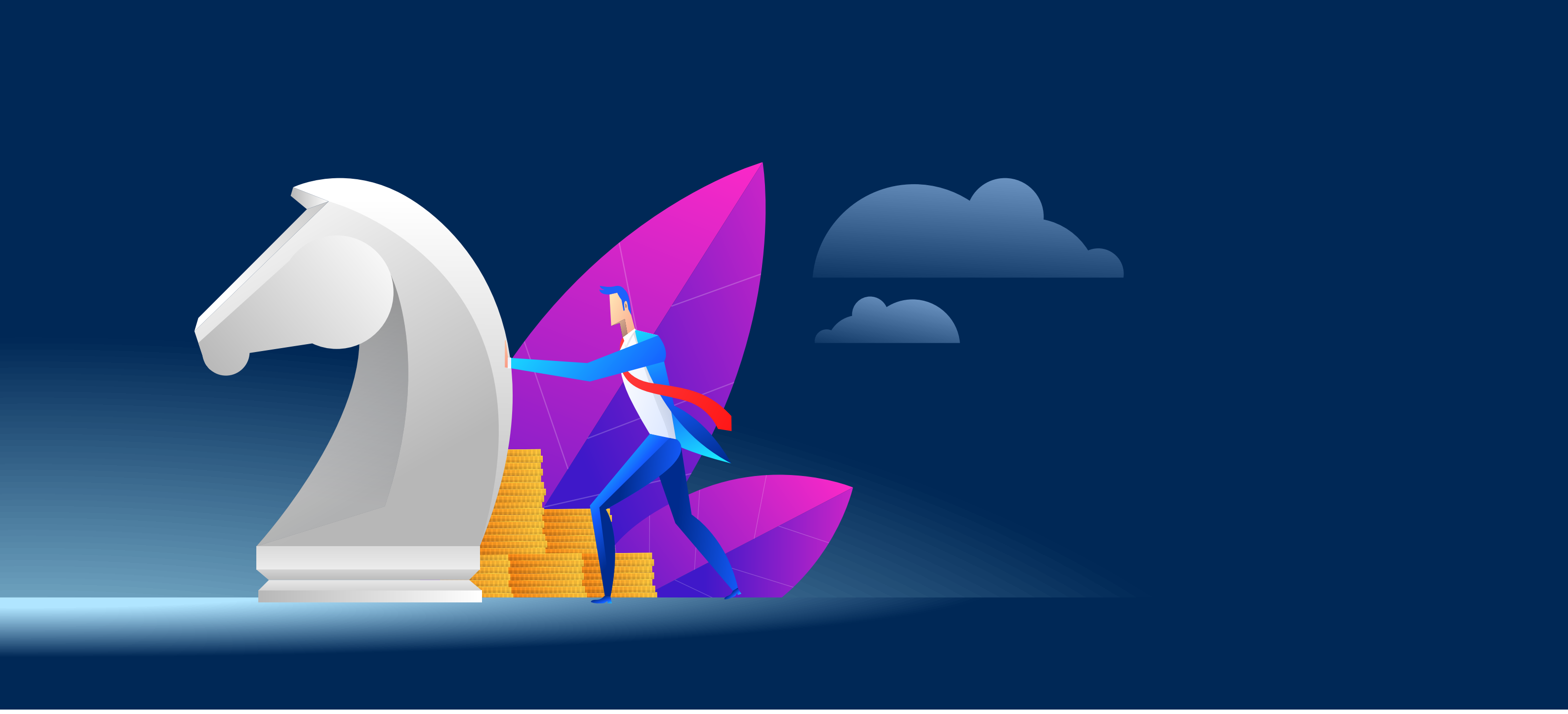
Globally, mergers and acquisition ('M&A') transactions have seen an upsurge in 2018, with announced transaction volumes reaching $4.1 trillion, with growth likely to carry on in 2019 as well.[1] As the volume of M&As grow, disputes in relation to M&A transactions may correspondingly also be on the rise. In an increasingly globalised world, cross-border M&As should be of increasing relevance, and therefore merit consideration. This development, in itself, is significant and should inform understanding of future challenges, and trends in resolving the same.

The unique nature of M&A transactions especially in the context of cross-border transactions, very often leads to arbitration being the mode of dispute resolution of choice. This is largely because arbitration in M&A has the benefits of commercial effectiveness, neutrality of forum, choice of arbitrators, and more importantly, the arbitral process allows parties necessary flexibilities in handling proceedings.[2]

Unique concerns which arise in the case of cross-border M&A transactions include pre-closing disputes, post-closing disputes which include within its ambit purchase price adjustments, claims over indemnification rights, disputes over representations, warranties and indemnifications, as well as disputes over shareholder rights (such as rights of exit and buy-outs). Additional issues include the choice of international arbitration *v* expert determination, fraud claims and disputes over clauses in the nature of buy-out clauses, call and put options, and pre-emption rights.

In light of the significance of this topic, the present paper discusses the above issues in the context of the treatment of the same in the Indian experience. Thus, to that extent, the present paper aims to provide an overview of the legal treatment of the issues indicated above, in light of legal precedent in India, with the exception of Part I, which is a functional discussion.

The paper is structured into four parts. Part I deals with both pre- and post-closing disputes, and touches on price adjustments and earn-out provisions specifically. Part II deals with potential challenges arising out of the difference between expert determination and arbitration. Part III discusses the concepts of representations, warranties, indemnities and fraud claims in Indian law. Part IV deals with key issues that may arise in shareholder disputes involving put and call options, oppression & mismanagement, pre-emption rights, which are relevant in the context of arbitration under Indian law.



Potential for M&A disputes in post-closure of transactions

M&A disputes, by their very nature, can occur over the entire life-cycle of a M&A transaction. However, it is the case that within the universe of M&A disputes, often most disputes may occur after a transaction has been closed i.e. the most common M&A disputes often relate to what are called '*post-closing disputes*'.[3]

Post-closing disputes

Post-closing disputes are heavily fuelled by the long list of representations, warranties and indemnities parties usually enter into while dealing with the issue of allocation of risks. Post-closing disputes may also be fuelled by what are called '*purchase price adjustments*'. Most adjustment mechanisms deal with accounting for value changes of the target company between signing and closing, and disagreements may often crop up in relation to calculating earn-out parameters (such as, earnings before interest, taxes, depreciation, and amortization or EBIDTA). Disputes in these areas often concern issues such as scope, meaning, application and interpretation of the price adjustment provision, application of accounting principles and other considerations.

In this regard, price adjustment clauses have largely become a common-place feature in M&A transaction documents. The mechanism of purchase price adjustment clauses is usually based on parties defining relevant indicators in transaction documents and agreeing on a provisional purchase price, payable at closing. In the wake of closing, parties agree on calculating adjustments which may lead to an additional payment by the buyer or a refund by the seller. Importantly, escrow mechanisms may also find place under the described arrangement. Recently, transactions are also becoming subject to '*locked box*' arrangements where parties agree on a fixed price on a particular date, but provide for specifically defined outflows not occurring between this date and signing or closing.

Therefore, purchase price adjustments represent a ubiquitous feature of M&A transactions, and often represent the most heavily negotiated and litigated provisions. Commonly, the most frequently occurring post-closing purchase price adjustments are closing balance sheet adjustments and earn-outs. A brief overview of these two kinds of price-adjustments are provided below.

Post-closing disputes: Price adjustments & closing balance sheet adjustments

Closing balance sheet adjustments take into consideration changes in the valuation of the target business between the date of signing of the agreement and the final closing.

Such adjustment provisions compare a closing balance sheet amount to a reference balance sheet amount, and accordingly adjust the purchase price for variations. Balance sheet items being compared differ and vary from parameters such as net working capital to debt to net assets or even cash balances.

In practice, a preliminary balance sheet is usually prepared by the seller, which is then compared to a reference balance sheet, by the parties. If significant variations do not come to light, parties usually close the deal based on the preliminary balance sheet. In the event differences come to light, parties may refuse to close the deal, which leads on to a pre-closing negotiation of an adjustment to a purchase price. Expert determination may also be roped in at this stage, and parties may base a post-closing purchase price adjustment on the final closing balance sheet.

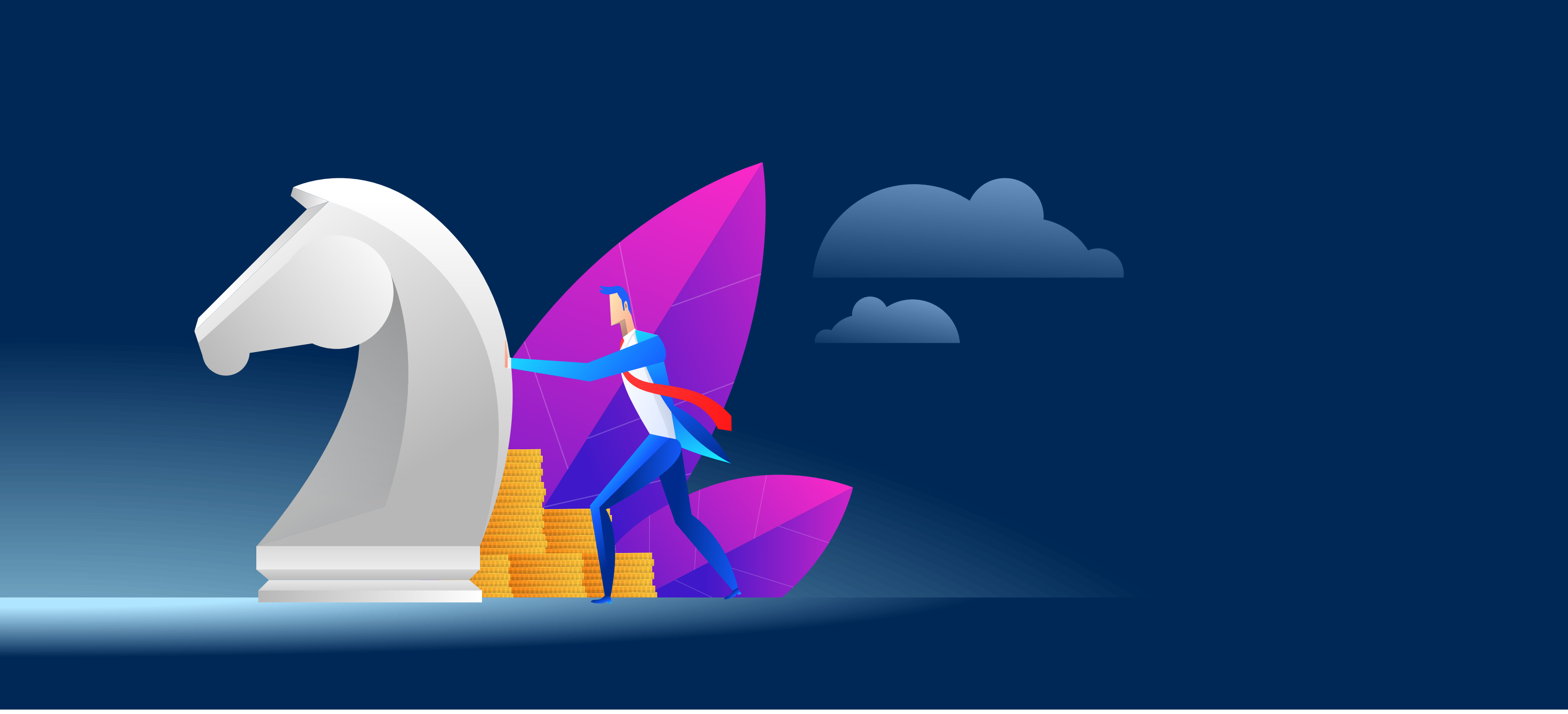
It is interesting to note here that the practice in the United Kingdom ('**UK**') is to follow the '*locked box*' approach, as opposed to the United States ('**US**'), where a majority of M&A transactions address pre-closing value fluctuations by means of a working capital or similar purchase price adjustment provision.[4]

In the context of the US, post-closing disputes have been said to centre on the issues of expert determination *versus* decision by a court, coverage under indemnification clause *versus* the post-closing purchase price adjustment provision, and applicable accounting principles.[5] In the context of the UK, most notable cases in relation to price adjustments have centred on deferred consideration mechanisms.[6] For instance, in *Starbev GP Ltd v Interbrew Central*[7], it was held by the Court of Appeal (in the context of a proportion of profit realised by the buyer when the business was sold within a period of three years) that the drawing down of consideration by the buyer was caught by the agreement's anti-avoidance clause, as it sought to reduce the seller's contingent value right.

Post-closing disputes: price adjustments & earn-out provisions

Earn-outs are provisions compensating the seller for potential which could not otherwise be captured, as it depends on the performance of the target business after closing. Such provisions typically provide the seller additional payments if certain income targets are met after closing. However, all said and done, as it is said "*an earn-out often converts today's disagreement over price into tomorrow's litigation over the outcome.*"[8]

In the context of the US, earn-out provisions are used frequently, and lead to disputes. Therefore, it has been suggested that specific, business-contextual drafting may hold the key to mitigate the risk of disputes.[9] Regardless, American courts have rendered a wide gamut of decisions on various aspects of earn-out clauses. These include, for instance, rulings on the point that there was no implied obligation on the buyer to increase earnout payments,[10] to disputes in relation to business strategy changes adopted by the buyer held as not breaching implied covenants[11]. While earn-out disputes seem to be more prolific in the US, notable disputes have also arisen from time to time in the UK. A prominent dispute in this regard arose in *Treatt PLC v Barratt and others*,[12] where the Court of Appeal held



that where the share-purchase agreement provided for consideration on the basis of audited accounts, a buyer's reliance on management accounts in preparing notice of its calculations of the earn-out, was invalid.

Pre-closing disputes

In addition to post-closing disputes, '*pre-closing disputes*' are equally significant, and lead to disagreements at the stage of pre-closing or pre-signing. Such pre-closing disputes may arise in situations where, for instance, the buyer may want to back out of the transaction because of non-fulfilment of contractual provisions, or even other, external reasons such as unavailability of transaction financing. Similarly, although less common, sellers may also wish to re-consider the transaction and pull out of the same. Pre-closing disputes, as enforced through arbitration, are seemingly less frequent (as opposed to post-closing disputes), since parties still retain interest in closing a successful transaction. Additionally, enforcement may represent a significant challenge due to considerations of timing; this implies often that resolving pre-closing covenants are not as common-place as post-closing disputes (although, fast-track arbitration may be a viable mechanism in such cases).

Issues arising from expert determination versus arbitration

Overview

Expert determination has often been used in the context of M&A transactions. It enables quick decision making by technical experts and is widely used in sectors like construction and natural resource industries. Unlike arbitration, expert determination is not governed by legislation. It is neither characterized as an arbitration under the New York Convention, neither is it enforceable as an arbitration award under domestic arbitration law. The adoption of expert determination is a consensual process by which the parties agree to take defined steps in resolving disputes. Controversies usually arise in relation to expert determination of Material Adverse Change (MAC) clauses, Purchase Price Adjustment, Earn Out, Put and Call options, Representation and Warranties and Losses. Because expert determination is not subject to arbitration legislation, the following issues become relevant in this context:[13] (a) under what circumstances would expert determination be considered final and binding; (b) when can an expert determination be reviewed; (c) when can an arbitral tribunal order expert determination; (d) whether court proceedings could be stayed in view of a pending expert determination.

Indian law

The Indian Supreme Court has laid down three tests for differentiating an arbitral award from an expert determination:[14] (a) existence of a dispute as against intention to avoid future disputes; (b) the tribunal or forum so chosen is intended to act judicially after taking into account relevant evidence before it and the submissions made by the parties before it; and (c) the decision is intended to bind the parties. This subtle legal distinction may have immense implications in terms of the status of the dispute resolution clause and the corresponding decision.

Key issues in disputes at post-closure: representations, warranties, indemnities and fraud claims

M&A transactions are at their heart, contracts to purchase and sell an '*asset*', in this case a '*target*' company. The M&A deal in itself, is styled as a contract, and therefore contractual grounds, which are specifically agreed upon by the transacting parties, often form the bases of legal disputes which may arise in relation to M&A transactions. In light of the above, this part deals with the treatment of representations, warranties and indemnities primarily under Indian law, aiming to point out areas of concern.

Representations and warranties

In M&A transactions, representations and warranties may be viewed as a means of comfort or assurance to the buyer of the target business in relation to the functioning of the business. This enables the buyer to assume the business of the target with confidence and assurance, that there is recourse to the buyer in case any adverse events subsequently come to light. Commonly, representations and warranties in the M&A context may pertain to statements of facts including solvency, state of business, compliance statuses, etc.

Representations and warranties deal with factual situations described by the seller who makes a host of representations and warranties in relation to the target (such as, its full ownership of the target, and the target fulfilling certain qualities in relation to financial statements, authorisations, litigation, intellectual property rights, etc).[15] Representations and warranties may cover aspects additionally, in relation to future contingencies.

The legal position on representations and warranties

In the Indian context, provisions of the Contract Act, 1872 ('**Contract Act**'), which provides for remedies in case of misrepresentation, as well as the Sale of Goods Act, 1930 ('**Sale of Goods Act**') which provides for remedies in the case of a breach of warranty, have a bearing on the subject of representations and warranties.

Generally speaking, a breach of a representation, in terms of the provisions of the Contract Act enables the right to rescind the contract and/or claim damages, a breach of a warranty generally leads to a claim in damages under the Sale of Goods Act.

In contract law, representations are statements made by one party to another and relate by way of affirmation, denial, description or otherwise to a matter of fact.[16] Representations which act as mere inducements to the making of contracts, and which the representor does not undertake to make good, render a contract voidable.[17] On the other hand, representations which act as a term of the contract itself may give rise to a claim of damages for breach of contract.[18] Often, which contractual term may be called a representation giving rise to the right to a party to avoid the contract *vis-à-vis* giving rise to a claim in damages, is a matter of ascertaining the intention of parties.[19]

On the other hand, under the Sale of Goods Act, a warranty is defined as *"a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated."*[20] While the Sale of Goods Act deals specifically deals with the law of sale on goods (and may therefore have limited relevance in the context of the discussion on M&As), it is useful to use the concept of a '*warranty*' contained thereunder to understand conceptual differences.

In this regard, a significant issue concerns when a particular contractual covenant may be called a representation, and when it may be called a warranty. The nature of whether a particular contractual covenant is a representation or warranty significantly influences remedies which may be available for breach of contract. One of the most significant judicial pronouncements, explaining the law on representations and warranties happens to be the decision of the High Court of Madras in *All India General Insurance Co v. S P Maheswari* [21] ('**Maheswari**'). It was held in this case, that "*Warranties are representations which are made the basis of the contract whereas a representation is not strictly speaking a part of the contract or of the essence of it, but rather something preliminary and in the nature of an inducement to it*".[22] The position in Maheswari has been re-iterated in *New India Assurance Company Ltd. V K. Radhakrishnan*,[23] where it has been observed that "*Warranty is different from a representation in the sense that the former requires a strict and literal fulfilment, but the latter may be satisfied with substantial and equitable compliance. The contract does not exist unless the warranty is literally complied with. It is a promissory warranty by which the assured undertakes that some particular thing shall or shall not be done or that some condition shall be fulfilled or affirms or negatives the existence of a particular state of facts.*" Significantly, the Supreme Court in *P.C. Chacko vs Chairman, LIC*[24] again re-iterated the distinction between representations and warranties as enunciated in Maheswari.

It is important to state here that in terms of the Contract Act, in case of a breach of contract, the party not at fault, is entitled to receive compensation for "*any loss or damage caused*", which "*naturally arose in the course of things from such breach*", or which the parties knew, *"to be likely to result from the breach of it."*[25] However, the Contract Act explicitly excludes damages for remote or indirect losses, as well as damages sustained by reason of the breach. Thus, under the Contract Act, damages for breaches of contract are awarded as compensation for the loss, damage or injury suffered as a result of the breach of contract. Unlike the remedy of specific performance (which is discretionary), damages are available as a matter of right when there is a

breach of contract; however, damages, even if proven, are not always a full recompense for loss as rules on damages continue to apply (most notably, the rules on remoteness of damages,[26] as well as the duty to mitigate damages[27]).

Representations and warranties: special considerations in M&A contracts

Though a standard feature of the law of contracts, in the specific context of representations and warranties in the field of M&As, typical concerns may arise. [28]

For instance, the existence of a duty of disclosure may be a relevant consideration in this regard. There is generally no duty of disclosure of facts which may be within the knowledge of the parties, unless it is a contract *uberrimae fides*[29]. This may be the case, for instance, with contracts of insurance which have been traditionally considered to be contracts of utmost good faith, and where a failure to disclose may give rise to the right to the insurer to repudiate the contract.[30]

The impact of due diligence by a buyer on supposed breaches of representations and warranties, and ensuing reliefs is also another aspect gaining prominence, which may have a bearing in the specific context of M&A transactions. In relation to the aspect of due diligence, courts have tended to take the view that ordinary due diligence depends on the facts of each case and that merely by virtue of placing on record a document, the conclusion could not be reached that every officer has the means of discovering the truth.[31] Additional complexities are also being introduced with interactions of questions of fraud with breaches of representations and warranties and inducement to enter into contract.[32]

Indemnities

The issue of indemnification often arises because representations and warranties are backed by indemnities from sellers. [33] This is often because sellers are liable for breaches of representations and warranties in the form of indemnification claims by buyers. In practice, while sellers may exclude or limit liability (in terms of both claim amounts and time), such limitations often follow extensive negotiations between parties.

Given that representations and warranties often form a pivotal part of an M&A transaction, it is no surprise that indemnification provisions are intensely negotiated. Sellers limit indemnification provisions by putting a cap on indemnity amounts and claim periods. Sellers may also resort to limiting indemnity liability by basket and *de minimis* provisions. The former refers to minimum thresholds which must be exceeded by the aggregate amount of all losses claimed by buyers, while the latter deals with a minimum threshold which prevents a buyer's claims from being eligible for indemnification unless it exceeds a certain amount. However, often certain matters may be excluded from limitations of baskets, caps and deductibles. Limitations in this mould often include breaches of fundamental and tax representations and warranties, covenants, fraud and specific indemnities.

The legal position on indemnities

Under Indian law, the provisions of the Contract Act have a bearing on the subject of indemnities. The Contract Act defines a contract of indemnity in the following terms: "*A contract by which one party promises to save the other from loss caused to him by the contract of the promisor himself, or by the conduct of any other person, is called a contract of indemnity.*" [34]

In terms of the legal position under the Contract Act, where the promisor of the indemnity incurs an absolute obligation, he can sue for enforcement, without the occurrence of actual loss.[35] Indemnities are distinguishable from the right to receive damages arising from a breach of contact.[36] The right of indemnity is a separate contractual right in itself, while the right to receive damages arises as a consequence of the breach of contract.[37] It is often possible that whenever a contract is broken, indemnity often coincides with the right to receive damages. Thus, whenever a contract has an indemnity clause which does not exclude the right to claim damages, there exists an option to claim damages for breach or payment of indemnity.[38] Further, it should be noted that the extent of liability under an indemnity usually refers to the nature and terms of contract.[39] However, it should be noted that the provisions of the Contract Act do not contain the entire law on the subject of indemnities.[40] Finally, it is important to note that the contractual remedy of an indemnity differs from damages. The right to indemnity persists as an integral contractual remedy, whereas damages are payable only on breach of contract. Further, there are other important distinctions between the two concepts such as their being no duty to mitigate losses in the case of indemnity, unlike the case of claiming for damages of breach of contract[41].

Fraud claims

Fraud claims may arise post-closing of M&A transactions and after transfer of target assets or shares to the purchaser. They essentially relate to disputes regarding the validity of share purchase agreements and recession therefrom. The purchaser may allege that the seller had not disclosed information or documentation on the target, which could have influenced its investment decision. Such fraud claims usually provide the purchaser a longer limitation period than the contractually fixed limitation period for warranty claims. Moreover, fraud claims are not subject to the broad exclusions that apply to warranty claims.[42]

The overwhelming weight of authority holds that claims of fraud, fraudulent inducement, intentional misrepresentation and the like are capable of settlement by arbitration.[43] In *World Sport Group Ltd. v. MSM Satellite*,[44] the Indian Supreme Court held that an arbitration agreement does not become "inoperative or incapable of being performed" where allegations of fraud have to be inquired into and the court cannot refuse to refer the parties to arbitration as provided in section 45 of the Act on the ground that allegations of fraud have been made by the party which can only be inquired into by the court and not by the arbitrator. However, in *A. Ayyasamy v. A. Paramasivam and Ors.*, the Apex Court developed a subjective test in this regard.[45] It was held that mere allegation of fraud simplicitor may not be a ground to nullify at the effect of an arbitration agreement. However, in cases involving very serious allegations of fraud which make a virtual case of criminal offence or where they raise complex issues which can be decided only by a civil court on appreciation of voluminous evidence, arbitration agreement may be sidetracked.

A recent arbitration case involving fraud was *Daiichi Sankyo Company Ltd. v Malvinder Mohan Singh.*[46] Daiichi had entered into a Share Purchase and Share Subscription Agreement with the respondents in 2008 to purchase their total stake in Ranbaxy Laboratories Ltd. During the acquisition process, the respondents made false representations to the petitioner by concealing a document and also regarding pending investigations by US Food and Drug Agency ('**FDA**') and Department of Justice against Ranbaxy. These led to disputes between the parties, which were referred to arbitration under ICC. The Arbitral Tribunal passed an award against the respondents. First, it held that the limitation period under the Limitation Act, 1963 starts only upon the first instance when the knowledge of the trigger event comes to the knowledge of the claimant beyond reasonable doubt. Second, absence of indemnity agreement does not prevent the claimant from claiming indemnity for losses arising out of an established misrepresentation under section 19 of the Indian Contract Act, 1872.

Daiichi sought enforcement of this foreign arbitral award in India. The respondents objected to its enforcement under section 48 of the Arbitration and Conciliation Act, 1996. The Delhi High Court allowed enforcement and rejected the respondents' arguments. However, the court did not specifically opine on arbitrability of fraud in this case.

Key issues in shareholder disputes

Some issues that emerge in disputes relating to shareholders include put and call options, oppression & mismanagement, pre-emption rights. A critical aspect of any M&A deal is investor control rights through investment protection in case of shareholder disputes. These could broadly include put and call options and pre-emptive rights. Separately, statutory remedy is also available in the form of petition against oppression and mismanagement. The implications that these features may have for arbitrations in the context of M&A is the subject matter of discussion in this part.

Put and call options

Foreign investors usually prefer call & put options attached to their investments in an Indian company. A call option is the right but not an obligation to buy the shares in the Indian investee company from the Indian investor. It is intended to provide the foreign investor an option to take advantage of the upside of its investment. In contrast, a put option is the right but not an obligation to sell the shares in the Indian investee company to the Indian investor. It is intended to provide the foreign investor an exit option as a downside protection to its investment.[47]

Background[48]

Regulation of options on securities in India could be traced back to the Bombay Securities Contracts Control Act, 1925 (1925 Act). It permitted only exchange traded options. Due to losses suffered by investors from 1929 to 1938, a need was felt to reform the securities law. This ultimately led to the enactment of the Securities Contracts Regulation Act, 1956 (SCRA). The SCRA initially prohibited options in securities. Section 16 of SCRA empowered the Central Government to declare that no person shall enter into any "contract for the sale or purchase of any security specified in the notification" in a specified area without the permission of the Central Government. In 1969, the Central Government issued a notification which provided that all contracts for the sale and purchase of securities, other than spot delivery contracts or contracts settled through the stock exchange, were void.[49]

Post-liberalization, the Central Government delegated the power under section 16 of the SCRA to SEBI in 1992.[50] The SCRA was relaxed through an amendment in 1995 to remove the prohibition on options.[51] On March 1, 2000, the 1969 Notification of the Central Government was repealed. On the same day however, SEBI issued a notification along the same lines on the same day itself.[52] Consequently, there was no substantive change in the legal position regarding options. Contracts in securities continued to be considered void unless they are spot

delivery contracts or carried out through the stock exchange mechanism.

SCRA was clearly applicable to securities of public listed companies and not to securities of private companies. However, there was some confusion whether it applied to securities of public unlisted companies. This confusion was clarified by two legal instruments. First, the proviso to section 58(2) of Companies Act, 2013 provided that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract. Consequently, call or put options on securities of public companies became enforceable under Companies Act, 2013. Second, on October 3, 2013, SEBI issued a notification permitting options contracts in shareholders' agreements and articles of association of companies, subject to the condition specified therein.[53] It was further clarified that such options contract must comply with FEMA regulations issued by RBI. However, this notification did not validate any contract entered prior to the date of the notification.

On June 8, 2007, RBI had issued a notification observing the following:[54]

"It has been noticed that some Indian companies are raising funds under the FDI route through issue of hybrid instruments such as optionally convertible/ partially convertible debentures which are intrinsically debt-like instruments. Routing of debt flows through the FDI route circumvents the framework in place for regulating debt flows into the country."

To address this issue, RBI clarified that only instruments which are fully and mandatorily convertible into equity, within a specified time would be reckoned as part of equity under the FDI Policy and eligible to be issued to persons resident outside India under the FDI Scheme.[55] Accordingly, the RBI regarded put options in favour of non-residents as redeemable instruments, not permitted under the FDI regime.

This position changed on November 12, 2013 when RBI amended the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 ('**17th Amendment**'**).** It allowed options on shares or convertible debentures to be issued to non-residents only if they did not have an option/right to exit at an assured price. It also provided the pricing mechanism. For instance, in case of a listed company, exit should be at the market price determined on the floor of the recognised stock exchanges. In case of equity shares of unlisted company, at a price not exceeding that arrived on the basis of Return on Equity ('**RoE**') as per latest audited balance sheet.

Subsequently, RBI issued two circulars dated January 9, 2014[56] and July 15, 2014[57], by way of which options attached to equity shares and compulsorily and mandatorily convertible preference shares/debentures issued to non-residents by unlisted companies were permitted. However, this was subject to there being no guarantee of an assured return or exit price at the time of undertaking the investment. Assured return or exit price has been disallowed in option contracts since RBI is of the view that such contracts would be in the nature of debt as opposed to equity, thereby defeating the spirit of the foreign direct investment policy.[58]

These RBI circulars have often complicated enforcement of put options, leading to international commercial arbitrations, followed by court proceeding challenging the enforcement of the arbitral awards. The following cases illustrate the point.

Select case law discussions

Harbour Victoria Investment Holding Ltd. (2015)

Harbour Victoria Holdings Ltd. (Harbour), a wholly owned subsidiary of JP Morgan, had invested in 6.21% of the shares of BPTP Ltd. ('**BPTP**'). The shareholders' agreement between them had a put option, which allowed Harbour to sell to BPTP's promoter the first tranche of shares in case the Qualified Initial Public Offering ('**QIPO**') was not completed within a specific time. At the time of the investments, the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 were the governing regulations.

Following the investment, the market in which BPTP's business was in, deteriorated. In 2011, there were media reports that RBI may prohibit options with guaranteed exit price for a foreign investor. When BPTP failed to do a successful QIPO, Harbour triggered the put option. BPTP's promoter failed to comply, leading to the arbitration.

In this arbitration, the contention was regarding the date on which the price is to be calculated and the valuation methodology to be followed in view of the RBI circulars mentioned above. The Tribunal took the view that the July 8, 2014 Notification and Circular 4 were not applicable as these were issued subsequent to parties agreeing to the consent order. Therefore, the methodology in the 17th amendment and Circular 86 were followed. It was also held that the exit occurs when the investor exercises the put option, not when share price is paid to the investor or when the shares have been returned to the company and the investor ceases to be a shareholder.[59]

NTT Docomo v. Tata Sons (2017)

In 2009, NTT Docomo Inc. ('**Docomo**'), Tata Sons Ltd. ('**Tata**') and Tata Teleservices Ltd. ('**TTSL**') entered into a shareholders' agreement. Under the agreement, Tata was required to find a buyer for Docomo's shares in TTSL, in the event that TTSL failed to meet certain performance parameters. The sale price was required to be the higher of (i) the fair value of the shares; or (ii) 50% of the price at which Docomo had purchased the shares.

In 2014, Docomo exercised this right, requiring Tata to find a buyer for its shares in TTSL. Tata chose to buy the shares itself. However, since it failed to obtain the necessary approval from RBI, Tata failed to buy the shares. The Tribunal found Tata to be in breach of the agreement and ordered Tata to pay damages for breach of contract.

Tata challenged the arbitral award in Delhi High Court. The Court examined the validity of the compromise terms agreed between the parties, and held that they were enforceable as well. The fact that the award was in the nature of damages (and not specific performance requiring purchase of shares), and that the two parties had ultimately reached a compromise, were factors which influenced the court's reasoning.

Cruz City v. Uniech Ltd. (2017)

By way of a Shareholders' Agreement ('**SHA**'), Cruz City

had invested in Kerrush Investments Limited (a Mauritius company) which, through its downstream subsidiaries in India, was to undertake some real estate projects. Under the SHA, Cruz City was entitled to exercise a put option by which it could call upon Burley to purchase its shares in Kerrush at a "post tax IRR of 15% on the capital contributions made by Cruz City in the event commencement of construction of a specified real estate project was delayed before the specified period". Under a separate Keepwell Agreement entered into between Cruz City, Burley and Unitech, Burley agreed to undertake obligations under the SHA in relation to the put option, and Unitech in turn agreed to make sufficient funds available with Burley so as to enable Burley to undertake its obligations towards Cruz City. In 2010, due to delays in the specified real estate project, Cruz City exercised the put option. Due to the failure by Burley and Unitech to comply with the same, Cruz City initiated an LCIA arbitration and obtained an award against them. Unitech challenged the enforcement of the award before Delhi High Court as a violation of public policy since it contravened FEMA regulations.

The Delhi High Court rejected Unitech's challenge on four grounds. First, it found that the SHA and the Keepwell Agreement together imposed on Unitech only a payment obligation to fufill its commitment to stand behind Burley, and it had no compulsion to purchase the shares of Kerrush, which could instead be purchased by Burley (which is a foreign company and hence not subject to restrictions under FEMA such as pricing norms). Second, the Court relied on the representations and warranties made by Unitech regarding the enforceability of its obligations to conclude that Unitech cannot take advantage of the falsity of its own representations. Third, the Court also found that Unitech's obligations under the Keepwell Agreement was in the nature of a guarantee of the obligations of its subsidiary, Burley. Since an Indian company can provide guarantee on behalf of its wholly owned subsidiary under the Foreign Exchange Management (Guarantees) Regulations, 2000, the Court held that Unitech is bound by its obligations. Finally, the Court upheld the put option since the assured return was possible only in the event of certain contingencies and not otherwise.

Oppression and mismanagement

Section 241 of the Indian Companies Act, 2013 confers statutory rights on members of a solvent company to seek remedies by way of a petition to the court on the grounds of oppression and mismanagement causing unfair prejudice. In the context of arbitration, a relevant issue that has arisen across jurisdictions is whether this statutory right could be contracted out through an arbitration agreement. While common law jurisdictions like UK and Hong Kong have taken a pro-arbitration approach in this context,[60] Indian courts have often discouraged arbitration of such disputes.

Indian law

The question of arbitrability of oppression and mismanagement has arisen before the Indian judiciary from time to time. In *Booz Allen & Hamilton v. SBI Home Finance*[61], the Supreme Court held that generally disputes pertaining to rights *in rem* are not arbitrable and right *in personam* are amenable to arbitration. The Court, however, noted that this was not a rigid rule and disputes that related to subordinate rights in *personam* which arose from a right in *rem* were arbitrable. Therefore, it could have been argued that the oppression and mismanagement cases by shareholders

arising out of the breach of a shareholder agreement or articles of association of the company, where the reliefs under section 402 of Companies Act, 1956 were not claimed, were arbitrable as they were contractual in nature and could be decided only by making a reference to those agreements.

This position was revisited by the Bombay High Court in *Rakesh Malhotra v. Rajinder Malhotra*.[62] While dealing with Companies Act, 1956, the court observed that wide and special powers were available to the Company Law Board ("CLB") under section 402 of the Companies Act, 1956 and the same power was not available with an arbitral tribunal. Moreover, the Court was of the opinion that a petition dealing with oppression and mismanagement necessarily deals with right *in rem* and therefore, raise issues incapable of being arbitrated.[63] Accordingly, it was held that oppression and mismanagement is not capable of being referred to arbitration. However, the court held that CLB (and now NCLT) may entertain an application for referring a dispute to arbitration. In this regard, the party seeking arbitration must also establish that the oppression and mismanagement petition is *mala fide*, vexatious and dressed up and that the reliefs sought are such as can be resolved by a private arbitral tribunal. Therefore, under the current law, disputes pertaining to oppression and mismanagement are not amenable to arbitration subject to the exceptions set out above. Effectively, this legal position allows lesser scope for arbitration compared to the position under *Booz Allen*.

The holding in *Rakesh Malhotra* has led the NCLT to conduct enquiry on merits to decide whether there was actually a case for oppression and mismanagement. For instance, in *Sidharth Gupta v. M/s. Getit Infoservices Ltd*,[64] the NCLT ruled that the dispute was a mere contractual dispute and not amount to oppression and mismanagement. Accordingly, it was refereed to arbitration.

Given this position of law in India, it is not precisely clear if a breach of contract, which is capable of being legitimately covered within a petition for oppression and mismanagement, would be arbitrable under Indian law or not. In this regards, it may be useful to recall the decision of the English Court of Appeals in *Fulham Football Club Ltd. v. Sir David Richards*.[65] The court in this case had observed that the determination of whether there has been unfair prejudice consisting of the breach of an agreement or some other unconscionable behaviour is plainly capable of being decided by an arbitrator. It is not a case where the arbitrator does not have the power to grant necessary relief, nor does it require some kind of state intervention that requires a court sanction. The court went on to observe that a dispute between members of a company or between shareholders and the board about alleged breaches of the articles of association or a shareholders' agreement is an essentially contractual dispute which does not necessarily engage the rights of creditors or impinge on any statutory safeguards imposed for the benefit of third parties. Unfortunately, the Indian law on this issue is not as clear.

Pre-emption rights

Shareholders' agreements ("SHA") and Articles of Associations ('**AoA**') often provide for a right of pre-emption clause in the event that either of them seek to part with or transfer their shareholding in the company formed by them. Right of preemption clauses provide protection to a shareholder by creating restrictions or obligations on other shareholders' freedom to transfer shares to a third party or another shareholder. Such right

usually takes the form of a right of first offer ('**ROFO**'), a right of first refusal ('**ROFR**'), drag-along or tag-along rights. These clauses are explained in brief below.[66]

The ROFO essentially means that if the investor wants to sell its shareholding in the company, it must make an invitation to offer to the promoter, who will then have the option to make an offer for the shares. If the investor accepts the offer made by the promoter, an agreement to sell the investor's shares to the promoter comes into being. If not, the investor will be free to sell its shares to a third party, but only for a price higher than was offered by the promoter and within a stipulated time period.[67]

In contrast, when shareholders agree to a ROFR clause, the investor presents the offer made by a potential buyer of the shares, asking the promoter as to whether they would like to match the terms made by the potential third party buyer. If the promoter accepts the offer, an agreement to sell the investor shares to the promoter comes into being. If not, the investor may sell it shares, but only to the identified third party buyer and at the same terms as had been originally offered.[68]

A drag-along provision gives one or more shareholders a right to force other shareholders to sell their shares at the same price and upon the same terms as the shareholder exercising the drag-along right. A drag-along right can be attractive because it effectively grants shareholders an option to sell a larger stake of the company than they own, and thereby realize a higher sale price, without adhering to certain legal and procedural requirements normally associated with such sales. Prospective acquirers of a corporation also view drag-along rights favorably, as they facilitate the acquisition of all or significant blocks of the corporation's outstanding shares.[69]

Tag-along provisions typically require that shareholders who propose to sell any of their shares offer the other shareholders an opportunity to sell a *pro rata* portion of their shares to the same purchaser on the same terms and conditions. Tag-along provisions are generally used to (i) give minority shareholders an opportunity to share in any control premium that may be available if a controlling ownership position is sold and (ii) protect shareholders from being "left behind" when other shareholders are able to realize a liquidity event.[70]

Indian law

In India, legal issues have arisen around enforceability of such preemption clauses.[71] This is because section 111A of Companies Act, 1956 provided that shares or debentures and any interest therein of a public company shall be freely transferable. This section did not apply to shares or debentures of private companies. Moreover, section 9 of the Companies Act, 1956 provided that the provisions of the Act would override anything contrary contained in the AoA of a company. Therefore, it was often argued that right to preemption clause in the AoA of a public company was not enforceable for being contrary to section 111A. It may be useful to note that there was no such problem regarding private companies – the law has been clear that in private companies, restrictions to transfer of shares or debentures could be imposed through a right of preemption clause under the AoA. However, the Bombay High Court in *Holdings Ltd. V. S.M. Ruia*[72] had held that the law did not intend to take away the right of the shareholder to enter into consensual arrangement/agreement with the

purchaser of their specific shares. The fact that shares of a public company can be subscribed and there is no prohibition for invitation to the public to subscribe to shares, unlike in the case of a private company, does not whittle the right of the shareholder of a public company to arrive at consensual agreement in respect of shares held by him. Therefore, the Court held that shareholders have the freedom to transfer his shares on term defined by him, such as ROFR, as long as such term is consistent with the governing law and regulations. In *Bajaj Auto Ltd. v. Western Maharashtra Development Corporation Ltd.*[73], the Bombay High Court upheld its earlier ruling in *Holdings Ltd*. It explained that the statutory safeguard on free transferability of shares of public companies was originally envisaged to ensure that the Board of Directors of such companies cannot refuse transfer of shares except on the grounds specified in the said provision. It further held that shares of a company are movable property and the right of the shareholder to deal with his shares and/or to enter into contracts in relation hereto is nothing but a shareholder exercising his property rights. Therefore, contracts voluntarily entered into by a shareholder for his own shares giving rights of pre-emption to a third party or another shareholder cannot constitute a restriction on free transferability as envisaged in the statute.

The Companies Act, 2013 has now clarified this issue. The proviso to section 58(2) clarifies that any contract or arrangement between two or more persons in respect of securities of a public company shall be enforceable as a contract. The intention behind this proviso is evident from the 57th Report of the Parliamentary Standing Committee on the Companies Bill 2011 which noted that the proviso to section 58 simply seeks to codify the pronouncements made by various courts holding that contracts relating to transferability of shares of a company entered into by one or more shareholders of a company (which may include promoter or promoter group as a shareholder) shall be enforceable under law. Keeping in line with this position of law, the Securities and Exchange Board of India (‘**SEBI**’) has also issued a notification dated October 3, 2013, recognizing the enforceability of contracts for pre-emption including right of first refusal, tag-along or drag-along rights contained in shareholder agreements or articles of association of companies. The Bombay High Court in *Bajaj Auto* took into account these legal developments, to note that the proviso to section 58(2) now recognizes the enforceability of pre-emption clauses in India.

Conclusion

This paper has elaborated the concerns which arise in the case of cross-border M&A transactions including pre-closing disputes, post-closing disputes which include within its ambit purchase price adjustments, claims over indemnification rights, disputes over representations, warranties and indemnifications, as well as disputes over shareholder rights. Additional issues include the choice of international arbitration as against expert determination, fraud claims and disputes over clauses in the nature of call and put options and pre-emption rights have also been discussed. While the law is clear on certain aspects, in others there is room for improvement. Taking into account this legal position and the legal risks emanating from the same, stakeholders need to draft their arbitration agreements with caution to ensure predictability in resolution of disputes arising in the context of cross-border M&As involving Indian companies and shareholders.

Endnotes

1 See, JP Morgan Chase, '2019 Global M&A Outlook: Unlocking value in a dynamic market' (January 2019) < https://www.jpmorgan.com/jpmpdf/1320746694177.pdf> accessed 4 August 2019.

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11 See, *Fireman v. New America Marketing In-Store* (District Court for. Massachusetts, 2009).

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14 *K.K. Modi v. K.N. Modi*, (1998) 3 SCC 573; *Bharat Bhushan Bansal v. U.P. Small Industries*, (1999) 2 SCC 166; *Bihar State Mineral Development Corporation v. Encon Builders (I)(P) Ltd.*, (2003) 7 SCC 418; *Vishnu v. State of Maharashtra*, (2014) 1 SCC 516.

15 See, Wolfgang Peter, 'Arbitration of Mergers and Acquisitions: Purchase Price Adjustment Disputes' Arbitration International (December 2003) Volume 19 Issue 4; See also, Frey and Müller 1115-1190.

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29 See, *Haji Ahmed Yar Khan v. Abdul Gani Khan*, AIR 1937 Nag 270.

30 See, Insurance Act 1938, Section 45. See also, Mulla 419.

31 See, *World Sport Group (India) Pvt. Ltd v The Board of Control for Cricket in India*, decision dated 20 December 2010, High Court at Bombay, [75].

32 See, *Daiichi Sankyo Company Limited v Malvinder Mohan Singh and Ors*, decision dated 31 January 2018, Delhi High Court.

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36 See, *Krishnaswami Iyer v Thathia Raghavaiah Chetty*, AIR 1928 Mad 43; *Keshwar Sao v Guni Singh*, AIR 1938 Pat 275.

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58 FDI is allowed in equity instruments and not in debt instruments. For debt instruments, the External Commercial Borrowing Policy is applicable, which imposes more stringent conditions.

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Notes

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