

INDIA - CROSS-BORDER M&A UPDATE

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Introduction

M&A transactions often include escrow and indemnification provisions.

Recently, the Reserve Bank of India (the “**RBI**”) has amended the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000, permitting parties to defer the payment of a certain portion of the consideration and open escrow accounts (to deposit the deferred consideration) in case of transfer of shares of an Indian company from a non-resident seller to an Indian resident acquirer and *vice versa*. The RBI has also imposed certain approval requirements on indemnity obligations.

This update discusses these recent changes notified by the RBI.

Deferment of consideration and opening of an escrow account

Earlier, prior approval of the RBI was required if parties to a deal wanted to defer the payment of consideration in case of a transfer of shares of an Indian company from an Indian resident seller to a non-resident acquirer regardless of the quantum of consideration. However, effective from May 20, 2016, the RBI’s approval is not needed in case of transfer of shares of an Indian company from an Indian resident seller to a non-resident acquirer and *vice versa*:

- (i) if the parties intend to defer only up to 25% of the total consideration for a period up to eighteen (18) months from the date of the transfer agreement; and

- (ii) if the parties seek to create an escrow arrangement for this amount of deferred consideration not extending beyond eighteen (18) months from the date of the transfer agreement.

Approval for indemnities

Under this notification, the RBI’s approval will be required if the seller wants to give an indemnity to the acquirer: (i) in an amount exceeding 25% of the total consideration; or (ii) for a period exceeding eighteen (18) months, from the date of the payment of the full consideration, and the total consideration has been paid by the acquirer to the seller.

How does this impact cross-border M&A?

Deferment of payment of consideration is resorted to in many M&A transactions. While the move by the RBI permitting consideration up to 25% to be deferred for a period up to eighteen (18) months from the date of transfer agreement is a welcome move, the rationale behind the monetary limit of 25% and the time limit of eighteen (18) months is unclear. Moreover, previously, no approval was needed for a deferment clause in a share sale agreement between a non-resident seller and an Indian resident acquirer. Therefore, adding something extra in the regulations makes little sense.

The curb on indemnification obligations is a major step backward and lacks rationale. Parties in a deal should be free to commercially agree on indemnification obligations without any

fetters being imposed. By imposing an RBI approval requirement of this nature, the time taken to close transactions will increase significantly, as market standard norms require indemnities to be between 50% to 100% of the purchase consideration and for a period between two (2) to three (3) years, which can even extend up to the expiry of limitation periods (which is six (6) years for tax claims and up to five (5) years or even an unlimited period for claims arising out of breach of fundamental representations and warranties such as title to shares, property, etc.). Further, previously, no such approval was needed for an indemnification provision in a share sale agreement between a non-resident seller and an Indian resident acquirer, and imposing such a condition will delay exits for foreign sellers.

We hope the RBI revokes this notification as it relates to indemnification obligations.

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