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FIVE COMMON SLIP-UPS IN M&A

"*Things don't just fall into place by accident. A good dealmaker understands that it's his job to finesse things into place.*"

In this era of shrinking global markets, Mergers & Acquisitions ('**M&A**') are used as instruments of growth and to gain easy market access. Factors such as market expansion, opening up of economies, favorable regulatory frameworks, divestitures and realignments have led to an increase in the volume and size of M&As. This article attempts to deal with some of the common slip-ups that can be avoided in such M&A transactions.

Five common slip-ups – the legal standpoint

***Not so 'materially diligent' due diligence*.** Due diligence not only helps in identifying and mitigating risks associated with undertaking a transaction but also forms the basis for inclusion of key commercial and legal terms in the definitive documents. However, when faced with a large volume of information to review and tight deadlines, it is easy to lose focus and overlook material issues. In order to ensure a result oriented, efficient and time bound due diligence exercise, it is essential that the scope of the diligence and nature of information and material to be reviewed be identified at the beginning and sought as part of the information checklist.

It is also possible for major impediments to the transaction to be overlooked during a diligence exercise due to non-provision of relevant documents, or information provided not pointing to any such road blocks. To prevent any such scenario, it is necessary to ensure that all the pertinent questions are asked and the necessary boxes ticked. Also, counsel should continue to have access to the data room till closure of the transaction towards evaluating any further information required to be looked at in light of disclosures made under the disclosure letter.

***Deal structuring without emphasis on tax considerations*.** While arriving at the structure and construct of the deal due regard should be given to the tax impact and exposure on the parties. Structuring deals as 'asset purchase', 'slump sale' or 'stock purchase' should be done by taking the overall tax implications of the structure into consideration. In the backdrop of the Vodafone case, it is pertinent that the legal viability of available double tax avoidance routes are considered before arriving at the structure. Where there is ambiguity on the tax treatment of a structure, an advance ruling or informal view of tax authorities should be obtained.

Further, in order to ring fence from adverse tax liabilities it is advisable that the transaction document contains specific indemnity provisions on tax or holdback/escrow of taxable amounts. Additionally, treatment of other applicable taxes on the structure such as service tax, VAT, customs duty, withholding requirements, etc., should be clearly dealt with in the transaction document and the final transaction consideration should be determined only after taking into account all such deductions and tax liabilities.

Not giving equal focus to commercial, regulatory and legal terms. It is often seen that parties put much greater emphasis and importance on the commercial and pricing aspects of the deal without thoroughly examining and evaluating the implications of obtaining requisite regulatory approvals such as from RBI and FIPB, legal provisions contained in the definitive documents. To prevent any unwarranted complications in the future, the legal, regulatory and commercial provisions in definitive document should be evaluated and considered in tandem. As such, definitive documents should be drafted with utmost care and sans any ambiguity.

Indemnification provisions not being adequately dealt with. While it is often the practice for standard indemnification provisions to be incorporated in definitive documents, care should be taken to craft indemnity clauses to cover specific risks and processes on a case to case basis.

Towards this, indemnity provisions can be crafted *inter alia* to include specific indemnities based on due diligence findings and anticipated future claims, towards limiting the seller's liability by setting out - indemnity caps, 'de-minimus provisions', limitation periods, materiality thresholds, subject matter limitations and other qualifications, to provide exemptions available under law such as indemnity against remote and consequential damages, to ensure that indemnification procedures and processes are clearly mapped, towards covering out of pocket expenses, loss of profits, attorney fees, etc.

Improper handling of employee transition. M&A transactions in particular require proper handling of employee transitions in order to ensure smooth transfer of the business from sellers to purchasers. This requires that the terms of employee transition be translated in the deal document as also communication of thereof to such employees. Care should however be taken to ensure that any such communication of transition terms be balanced with the seller's confidentiality obligations. It is ideal that preliminary discussions are held between the company and employees on issues such as the buyer's plan for retention of employees, cherry picking of employees, liability of retrenchment payment (if any), continuity of employment on same terms, employment agreements of key employees, treatment of existing employee stock options, etc.

Further matters such as transfer of continuing benefits, employee liabilities and contract labor issues in which the principal employer has liabilities under the applicable laws, pending employee related claims, disputes, existence of trade unions, compliance with local laws, should be carefully checked and addressed in the deal document.

Conclusion

The common pitfalls in M&A transactions dealt with above can be avoided by taking a more focused, pragmatic and cautious approach while drafting and negotiating the transaction documents. This would in turn facilitate smoother and quicker closings and help avert any unwarranted complications for the parties involved.