

CONTROL UNDER THE INDIAN MERGER REGIME: A DETAILED ANALYSIS UNDER COMPETITION ACT, 2002 AND SEBI TAKEOVER CODE

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The recent times have witnessed an increased involvement of business entities in several commercial transactions essentially in the nature of mergers and acquisitions. The number of such transactions have thus increased manifold in the recent years. The foremost rationale behind any entity entering into such transactions is, in laymans terms to gain control over its operations and functions and profits. However the analysis of this term 'control' has not been an easy task and the intricacies in the same are still leading to a lot of confusion and controversy in this arena. Further, several definitions of the term have added to this uncertainty and blurred the understanding of it. This paper would thus look through the lens on the nature and scope of the word 'control' while highlighting the several existent definitions of the term; especially as defined under the Competition Act, 2002 and SEBI Takeover Code. The paper is also a humble effort to throw light upon the situation in India with regard to such transactions in the nature of gaining control and also compare the same with the interpretations in other jurisdictions.

Keywords: Control, Competition Act, 2002, Takeover Code, Merger, Acquisition

INTRODUCTION

Though India received its political independence in 1947 it took the country 44 more years to be economically independent with the adoption of the economic reform policy along with the liberalization privatization and the globalization policies. The adoption of these policies changed the entire economic scenario in the country paving way for more foreign investments, export and imports etc. The merger control regime was an area which had a huge impact as it lead to repealing of the merger provisions from the MRTP Act, 1969 and introduction of takeover regulations that came about in the subsequent years.

The Securities and Exchange Board of India (Substantial acquisition of shares and takeover) Regulations, 1997 commonly known as the Takeover Code, was the main regulation which was introduced to discuss in detail about mergers as a form of combination and its various facets like how can control be obtained, who can be termed as acquirer, technique and manner of takeovers,

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disclosures to be made etc. It was further updated in the year 2011 which is the latest regulations on the same. One of the key features of the Code was the definition provided by it for the concept of “control” and what level of shares or voting rights or other rights (negative, affirmative, veto) had to be acquired by an acquirer in a target company for it to be termed as ‘control’ and thus would necessitate the fulfillment of certain obligations like public announcement and open offer, that form a part of merger procedure.

That being clear and established, the ambiguity later arose due to introduction of several definitions provided in various other Indian legislations in specific the Competition Act, 2002 which lays down a complete different definition of the word “control” and different thresholds for being subject to the provisions of the Act. This continues to create uncertainty in the minds of various investors or acquirers, not only Indian but also cross border who enter into such transactions in India. The cases that fell under the jurisdiction of the traditional Indian Courts, Competition Commission of India and the SEBI like the Network 18 and the TV 18 case, *Ashwin Doshi v. SEBI* though provided effective ratios, they did not successfully contribute in removing the ambiguity that existed in this regard. A detailed discussion of the above mentioned aspects is done below.

‘CONTROL’ AS UNDER SEBI TAKEOVER CODE, 1997 and 2011

Regulation 2(1) (c) of the SEBI Takeover Code, 1997 and Section 2(1)(e) of SEBI Takeover Code, 2011 defines ‘control’ as a three point characteristic, which if fulfilled, in alternative or in addition could be termed as control. These are:

- a) Power to appoint majority of the directors.
- b) Power to control the management of the company.
- c) Power to make policy decisions.

Any of these powers are exercisable by a person or persons acting individually or in concert, directly or indirectly by the virtue of their shareholding or management rights or shareholding agreements or voting agreements or in any other manner.¹ In addition, the Takeover Code also provides specific numerical threshold limits, any acquisition over which is said to gain ‘control’ in a company. The Takeover Code, 2011 increased the earlier prescribed limit of 15 % to 25% and states that *“No acquirer shall acquire shares or voting rights in a target company which taken together with shares or voting rights, if any, held by him and by persons acting in concert with him in such target company, entitle them to exercise twenty-five percent or more of the voting rights in such target company unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations.”*²

¹ Section 2(c), SEBI Takeover Code, 1997 and Section 2(e), SEBI Takeover Code, 2011

² Section 3(1), SEBI Takeover Code, 2011

Thus, in short, if the acquisition results into entitlement of 25% or more voting rights in the target Company, the acquirer is required to make an open offer to acquire at least 26% shares from the existing public shareholders of the target company in terms of the Takeover Code (open offer obligation)³.

Thus fundamentally, the takeover code lays down two sets of factors, one being qualitative (as defined under Section 2(1)(c) and Section 2(1)(e)) and the other being quantitative in nature (initial threshold limit of 25%), that define control. For example, the uncertainty would precisely arise in a case where an acquirer could acquire less than the mandatory offer threshold of 25% and still be required to make an offer if it is said to be in control of the target company due to the application of the factors laid down in Section 2(1)(c) of the Code.⁴ Hence as a consequence of the same, it has been observed that due to the existence of this ambiguity, the investors/acquirers apply the definition in a subjective manner, suiting their needs and circumstances.

This ambiguity was dealt by the various Courts; however it resulted in divergent judicial decisions. In *Rhodia SA v. SEBI*⁵ SAT held the acquirer in question had control as it had veto rights on “major decisions on strategic and structural changes. This was also majorly dealt with, in the case of *Ashwin K. Doshi v. Securities and Exchange Board of India*⁶, where the Securities Appellate Tribunal held that the definition of control under Takeover Code ‘gives illustrative instances of exercise of control’ and that the term ‘control’ by its very nature is incapable of any standard definition and its determination would vary from case to case. The Tribunal also held that the expression ‘control’ would necessarily mean effective control, in other words, de facto control and not mere de jure control. Whether a certain right amounts to de facto control or not requires a fact-intensive analysis.⁷

This issue was further discussed in depth in the case of *M/s Subkham Ventures Pvt. Ltd v. SEBI*⁸, which fundamentally dealt with the controversial question of whether negative rights would constitute ‘control’. Dealing with Regulation 10 and 12 of SEBI Takeover Code, 1997 the SEBI held that in addition to an offer under Regulation 10⁹, an offer had to be made under

³ PWC, Takeover Code, Referencer on (Substantial acquisition of shares and takeover) Regulations, 2011. M & A Regulatory Services, October 2011

⁴ IndiaCorpLaw, Defining “Control” in takeover regulations, May 29 2013, available at <http://indiacorplaw.blogspot.in/2013/05/defining-control-in-takeover-regulations.html>

⁵ Appeal no.36/2001, SAT Mumbai

⁶ 40 SCL 545 (SAT)

⁷ Swati Bajaj, *Acquisition of Minority Shareholding and Merger Control in India*, Competition Commission of India Internship Report, August 2013

⁸ Appeal no.8 of 2009, Date of decision :15.1.2010

⁹ Regulation 10 of SEBI Takeover Code, 1997 states that “No acquirer shall acquire shares or voting rights which (taken together with shares or voting rights, if any, held by him or by persons acting in concert with him), entitle such acquirer to exercise [fifteen] per cent or more of the voting rights in a company, unless such acquirer makes a public announcement to acquire shares of such company in accordance with the regulations.”

Regulation 12¹⁰ also. The appellant, M/s Subhkam Pvt. Ltd had acquired 24.26% stake in MSK Projects, by the way of a financial investment transaction. In furtherance of the same agreement, certain affirmative or veto rights are given to them. SEBI felt that many such clauses in the share subscription agreement like power of the appellant to appoint its nominee directors to the Board of the target company, right to amend articles , right to change share capital etc were in the nature of providing control to the Subhkam holdings and thus in excess of 15%¹¹ of voting rights, they were required to make an open offer for ‘acquisition of control’ under Regulation 12¹². The appellants contended that these rights were not in the nature of demonstrating ‘control’ but were only in the nature of effectively safeguard the rights of the appellants.

When an appeal to the same was made to the Securities Appellate Tribunal, a 2 member bench in support to Subhkam’s contentions, held that such clauses did not entitle transfer of ‘control’ while stating that ‘*control is not a proactive but not a reactive power*’ and that ‘*power by which an acquirer can only prevent a company from doing what the latter wants to do is by itself not control*’. Although SEBI appealed before the Supreme Court, the matter was disposed off by the Supreme Court without laying down any jurisprudence of the scope of definition of ‘control’.¹³ In specific it laid down that ‘keeping in view the above changed circumstances, it is in the interest of justice to dispose of the present appeal by keeping the question of law open and it is also clarified that the impugned order passed by the SAT will not be treated as a precedent.’

In the light of the SAT ruling in this case, the Takeover Regulations Advisory Committee (TRAC) emphasized on the need to revise the definition of ‘control’ to include the *ability* to appoint majority of the directors or to control the management or policy decisions of the target along with the *right* to do so. Such an inclusion intended to emphasize that the *acquisition of de facto control* should also trigger an open offer and not just *acquisition of de jure control*; a scheme that was already brought about in the *Ashwin Doshi case*¹⁴ SEBI elected to retain the earlier definition because the *Subhkam* case was pending before the Supreme Court at that stage. However, no clarification was provided later.

Since the decision of SAT was not held to be binding, in a similar case of acquisition of stake in Kamat Hotel Pvt Ltd by Clearwater Capital Partners, the SEBI again followed the same line of interpretation it had and clearly indicated its aversion to affirmative rights , veto rights and preemptive rights. It held that due to the existence of certain affirmative voting rights it

¹⁰ Regulation 12 of SEBI Takeover Code, 1997 states that “*Irrespective of whether or not there has been any acquisition of shares or voting rights in a company, no acquirer shall acquire control over the target company, unless such person makes a public announcement to acquire shares and acquires such shares in accordance with the regulations*”

¹¹ According to Section Regulation 10 of Takeover Code ,1997

¹² Regulation 12 , Takeover Code ,2007

¹³ Amarchand & Mangaldas & Suresh A Shroff and Co, *Takeover Regulations –Some new judicial interpretations*, Insight Issue XXVII , December 5,2011

¹⁴ Nishith Desai Associates , *Public M & As in India :Takeover Code Dissected , A Detailed Analysis SEBI Takeover Code , 2011 , August 2013*

amounted to control. The company then filed an appeal against SEBI's decision in SAT. This prospective decision by SAT is highly awaited as could be a turning point as to how 'control' is perceived under the SEBI Takeover Code.

In the year 2014, SEBI in its order¹⁵ dealing with the acquisition of Jet airways by Etihad airways where the moot point was whether an investment by Etihad Airways in 24% shares of Jet Airways (India) Limited and the terms thereof amount to Etihad obtaining "control" in Jet so as to require Etihad to make a mandatory open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the Takeover Regulations).¹⁶ In view of the facts that the effective control of 'Jet' remained with the Indian promoters and secondly that Etihad had the right to nominate only 2 out of 12 directors, the SEBI concluded that Etihad is not in "control" or "joint control" of Jet for the purposes of the Takeover Regulations and hence is not obligated to make an open offer to the shareholders of Jet.

Thus concluding, even with the existence of plethora of cases in this regard, 'control' as a concept is still interpreted subjectively under the Takeover Code. The Courts and quasi judicial authorities in the country have also not provided a conclusive definition to the same. Thus the uncertainty still exists.

'CONTROL' UNDER COMPETITION ACT, 2002

The concept of 'control' is a significant aspect in cases of merger. This is primarily because a merger can have several competitive and anti-competitive effects on the economy of a country. Thus, control has been carefully scrutinized as a part of the competition law regime in India. However, in spite of efforts by the Competition Commission and the other bodies, certain level of uncertainty has remained in this arena. A detailed discussion of the above has been done below:

Explanation (a) to Section 5 of the Competition Act, 2002 defines control and states that:

'control' includes controlling the affairs or management by:

- (i) *one or more enterprises, either jointly or singly, over another enterprise or group;*
- (ii) *one or more groups, either jointly or singly, over another group or enterprise*

¹⁵ WTM/RKA/CFD-DCR/17/2014

¹⁶ IndiaCorpLaw, SEBI order on 'Control' under Takeover Regulations, May 15 2014, available at <http://indiacorplaw.blogspot.in/2014/05/sebi-order-on-control-under-takeover.html>

On a plain reading, this definition provided under the Act does not clearly indicate towards what could be fundamentally termed as control. The difficulty regarding this is removed under Schedule I Item I where it is stated that

*An acquisition of shares or voting rights, referred to in sub-clause (i) or sub-clause (ii) of clause (a) of section 5 of the Act, solely as an investment or in the ordinary course of business in so far as the total shares or voting rights held by the acquirer directly or indirectly, **does not entitle the acquirer to hold twenty five per cent (25%) or more of the total shares or voting rights of the company,** of which shares or voting rights are being acquired, directly or indirectly or in accordance with the execution of any document including a share holders' agreement or articles of association, not leading to acquisition of control of the enterprise whose shares or voting rights are being acquired.*

This is clearly indicative towards the fact that if a company acquired more than 25% of share capital or voting rights of a company they are deemed to have control.

In several cases in the past, CCI has examined this issue of 'control'. The most landmark case in this regard was the takeover transaction between Reliance Industries and TV 18 group of companies. In this case, Reliance Industries Limited by the way of a trust created, Independent Media Trust (IMT) subscribed to convertible securities i.e Zero Coupon Optionally Convertible Debentures (ZOCDs) in the target company. The real debate arose when CCI observed that in the Investment Agreement, holder of each ZOCD had the option to convert the ZOCDs into equity shares of the target companies with voting rights at any time during a period of ten years from the date of subscription. Since the conversion option contained in each ZOCD entitles the holder to receive equity shares of the target companies, the ZOCDs are shares within the meaning of sub-clause (i) of clause (v) of Section 2 of the Act and the subscription to ZOCDs amounts to acquisition of shares of the target companies.¹⁷

Further, in the event of conversion of all the ZOCDs, IMT would hold more than 99.99 percent of the fully diluted equity share capital of each of the target companies. Acquisition of such a right to convert the ZOCDs into equity shares, at any time before the expiry of ten years from the date of subscription, confers on IMT the ability to exercise decisive influence over the management and affairs of each of the target companies and the same amounts to control for the purposes of the Act.

Considering these two clauses the CCI held that in the instant case, the subscription to the ZOCDs amounts to acquisition of control over the target companies for the purposes of the Act. Since control over the target companies is being acquired by IMT, the subscription to ZOCDs in-

¹⁷ Paragraph 14 of the CCI order No. C-2012/03/47; dated May 28, 2012.

turn would also result in indirect acquisition of control over Network18 and TV18 as these companies would be under the control of the target companies.¹⁸

This order of the CCI brought the question of importance of control in analyzing the competitive effects of a merger, into the limelight. Thus the combination of two independent profit making bodies into one common ownership structure, turning into a dominant business entity in the market was highlighted and since then debates and discussion in the topic increased.

In the same year, CCI examined the same issue in the case of acquisition of shares in Multi Screen Media Private Limited. In this case, two separate entities of the Sony group purchased collective shareholding to the extent of 32.39 percent. Approving the proposed combination, CCI acknowledged that joint control over an enterprise could arise due to contractual agreements between its shareholders and held that the present acquisition would transfer from joint to sole control.¹⁹ CCI specifically identified four types of rights which may be construed to confer 'control' over an enterprise by the investor(s).

These include veto rights with respect to (a) engaging in a new business or opening new locations/offices in other cities; (b) appointment and termination of key managerial personnel (including material terms of their employment); and (c) material terms of employee benefit plans. At the same time, CCI was careful in distinguishing rights resulting in a situation of joint control from mere investment protection rights. It qualified its decision by saying that an assessment of control would depend on the facts and circumstances of each case, with due consideration to the statutory and contractual rights of the shareholders.²⁰

CCI further elaborated on the concept of 'control' in a more recent decision pursuant to which the acquisition of joint control by Century Tokyo Leasing Corporation over the leasing division of Tata Capital Financial Services Limited was approved. In its order, CCI observed that veto rights could create a situation of control over the assets and operations of an enterprise when they pertain to –

- (a) approval of the business plan;
- (b) approval of annual operating plan (including budget);
- (c) discontinuing any existing line or commencing a new line of business; and
- (d) appointment of key managerial personnel and their compensation.²¹

¹⁸ Paragraph 15 of the CCI order No. C-2012/03/47; dated May 28, 2012.

¹⁹ Paragraph 12 of CCI order on Combination Registration No. C-2012/06/63 dated August 9, 2012

²⁰ Aparna Mehra and Rahul Satyan, *India – Concept of Control under Competition Act, 2002*, April 2013, available at <http://www.conventuslaw.com/india-concept-of-control-under-the-competition-act-2002/>

²¹ Combination Registration No. C-2012/09/78 dated October 4, 2012

Thus, as seen from the above discussion, CCI has done well to identify the broad contours of what may constitute control in the context of acquisition of minority stake in a company, the ultimate analysis would vary from case to case. Investors and the industry, on the other hand, must keep in mind that the accrual of rights which go beyond the traditional minority protection rights, in lieu of an investment, may trigger a notification requirement to CCI, subject to asset & turnover thresholds.

DIFFERENCE IN TREATMENT OF ‘CONTROL’ UNDER TAKEOVER CODE AND COMPETITION ACT, 2002

There is grave difference between how ‘control’ has been defined under the takeover regulations in comparison to the Competition Act, 2002. While the essence of the definitions are similar, the ultimate objective which the definition serves is totally different. The Takeover Code fundamentally deals with ‘control’ only in a public listed company. On the other hand, the Competition Act, 2002 deals with acquisition of ‘control’ of public listed companies as well as unlisted companies.

As already mentioned above, the key rationale behind implementation of the Competition Act, 2002 was to prohibit abuse of dominant position of merged companies and the consequent ‘appreciable adverse effect’ that it would have on the competition in the market. Thus, while determining whether a particular transaction would lead to gaining of ‘control’ with respect to the Competition Act, 2002 and through the eyes of the Competition Commission of India the most vital aspect which is considered is whether the level of control acquired is of such extent as would enable the acquirer to have the ability to consistently determine the competitive behavior of an enterprise.²² On the other hand, the notion of ‘control’ under the Takeover Code focuses on a completely different aspect of fair and equal treatment to all shareholders in an acquisition or merger transaction.²³ Thus, it aims to provide an easy exit opportunity to the shareholders in case a new person acquires the control of the Company.

Another distinguishing factor is the most controversial question of negative rights. Negative rights allow a person to prevent certain actions, but can rarely confer the ability to control the behavior of an enterprise, so as to affect market dynamics on an ongoing basis in order to cause an ‘appreciable adverse effect’ in a particular market.²⁴ On the other hand in the precedents laid down in reference to Takeover Code, negative rights have a vital role to play as acquisition of such rights (in SEBI’s views) are said to acquire control of the company.

²² Nandish Vyas and Praniti Ishwar, *The viewpoint -The Anatomy of Control*, Bar and Bench, July 12, 2012, available at http://barandbench.com/content/212/viewpoint-anatomy-control#.VEIO7_mSx5q

²³ Swati Bajaj, *Acquisition of Minority Shareholding and Merger Control in India*, Competition Commission of India Internship Report, August 2013

²⁴ Nandish Vyas and Praniti Ishwar, *The viewpoint -The Anatomy of Control*, Bar and Bench, July 12, 2012, available at http://barandbench.com/content/212/viewpoint-anatomy-control#.VEIO7_mSx5q

In addition, the manner in which the control is said to be acquired is very much dissimilar in both. Under Takeover Code, control triggers the obligation to make an open offer. No such obligation is present under the Competition Act, 2002.

CONCLUSION

Though CCI and SEBI have taken numerous efforts to clear up this air of ambiguity around control in merger transactions with their respective laws and the several precedents laid down. However every new judgment passed by CCI and SEBI has led to a new controversy and debate. All our hope is now pending on the cases which are sub-judice in the CCI and SEBI. The ratio laid in them is likely to bring about certainty with regard to 'control' in merger transactions. Even though there is no settled law in this arena, considering the rate at which CCI and SEBI are working towards the same, there is hope that they would soon lay down express and precise law with respect to the same which would prevent any confusion in this regard in the future.